

Legislative Audit Division

State of Montana



Report to the Legislature

December 2004

Financial Audit

For the Fiscal Year Ended June 30, 2004

Montana State University

A Component Unit of the State of Montana

We performed a financial audit of Montana State University's consolidated financial statements for the fiscal year ended June 30, 2004. These financial statements present the financial position, the results of operations, and the cash flows, on a consolidated basis, of all four campuses affiliated with Montana State University: Montana State University-Bozeman; Montana State University-Billings; Montana State University-Northern (located in Havre); and Montana State University College of Technology-Great Falls. The statements include component unit financial information as required under GASB 39, implemented by the university for the fiscal year ending June 30, 2004. This report contains an unqualified opinion on the financial statements and accompanying notes for the fiscal year ended June 30, 2004, and the comparative information for the fiscal year ended June 30, 2003. The opinion means the reader may rely on the financial statement information presented.

This audit is performed to attest to the fairness of the consolidated financial statements of Montana State University. Audit issues, if any, identified during this audit have been discussed with university management.

Direct comments/inquiries to:
Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

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FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2005, will be issued by March 31, 2006. The Single Audit Report for the two fiscal years ended June 30, 2003, was issued on March 23, 2004. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

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James Gillett, Financial-Compliance Audit

December 2004

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial audit report on Montana State University's (university) consolidated financial statements for the fiscal year ended June 30, 2004. The statements include comparative information for the fiscal year ended June 30, 2003. The university requested this audit to provide timely audited financial statements to interested parties. The objective of our audit was to determine if the university's financial statements present fairly its financial position, changes in financial position, and its cash flows as of, and for the fiscal year ended, June 30, 2004. This objective included determining the university's compliance with laws and regulations having a direct and material impact on the financial statements. Our opinion, as it relates to the financial statements at and for the year ended June 30, 2003, is based on the audit we performed in the fall of 2003. For the period ending June 30, 2004, the university implemented Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations are Component Units*, an amendment of GASB Statement No. 14.

The university's financial statements report assets of approximately \$386.2 million, liabilities of approximately \$174 million, operating revenues exceeding \$257 million, and operating expenses of \$342 million, for fiscal year 2003-04. Net non-operating revenues and expenses were approximately \$88.9 million for fiscal year 2003-04. Of this amount, state appropriations accounted for approximately \$82.4 million. Cash flows for fiscal year 2003-04 consisted of the following: \$65.8 million used in operations; \$92.5 million provided by non-capital financing; \$24.2 million used in capital financing; and \$1.4 million used in investing activities for fiscal year 2003-04. The term "used in" refers to net cash outflows, while "provided by" refers to net cash inflows.

The Board of Regents of Higher Education approved the current Montana University System structure in January 1994. Montana State University consists of campuses located in Bozeman, Billings, Havre, and Great Falls. All campuses are accredited by the Commission on Colleges of the Northwest Association of Schools and Colleges. The Montana State University campuses provide a diversity of undergraduate and graduate academic and two-year vocational/technical programs to students.

Montana State University-Bozeman was founded in February 1893 as the Agricultural College of the State of Montana. It is a land-grant institution, authorized by the Morrill Act of 1862, and receives part of its support from land-grant income. The campus offers four-year undergraduate programs along with masters and doctoral graduate programs. It includes the Colleges of Agriculture, Arts and Architecture,

Business, Education, Health and Human Development, Engineering, Letters and Science, Nursing, and Graduate Studies.

The Bozeman campus also includes the Extension Service, the Agricultural Experiment Station, and the Fire Services Training School, which have facilities located in or near cities or towns throughout Montana.

Montana State University-Billings consists of five colleges: the College of Arts and Sciences, the College of Business, the College of Education and Human Services, the College of Technology, and the College of Professional Studies and Lifelong Learning. MSU-Billings offers a full complement of one-year and two-year certificate programs, associate degrees, and bachelor and master degrees, as well as pre-professional academic offerings in a number of fields.

Montana State University-Northern is a regional, multi-purpose educational center, serving students who seek both a technical and liberal arts education. It offers courses at the campus in Havre and at facilities in Great Falls. This campus offers associate, bachelor, and master degrees. A master degree program is offered in education, with options in counseling and development, elementary education, vocational education, and general science.

Montana State University College of Technology-Great Falls offers instruction leading to certificates in one-year programs and associate of applied science degrees in two-year programs in vocational-technical trades and industry. Programs include practical nursing, office/secretarial, interior design technology, computer and information sciences, various health-related programs, auto body repair and refinishing, dental hygiene, and business management/entrepreneurship.

A list of Appointed and Administrative Officials having oversight responsibilities with respect to Montana State University can be found beginning on page i.

Beginning on page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion on the university's consolidated financial statements, which means the reader can rely on the presented information.

This report does not contain any recommendations to the university. Any issues resulting from this financial audit have been discussed with university management. The university's response to this report is on page B-1.

We thank President Gamble and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

(Signature on File)

Scott A. Seacat
Legislative Auditor

Appointed and Administrative Officials

Board of Regents of Higher Education

John A. Mercer, Chair
Mike Foster, Vice Chair
Kala French, Student Regent
Lynn Morrison-Hamilton, Regent
Richard Roehm, Regent
Mark Semmens, Regent
Lila Taylor, Regent

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Office of the Commissioner of Higher Education

Sheila Sterns Rodger Barber	Commissioner of Higher Education Deputy Commissioner for Academic and Student Affairs
Rod Sundsted Pam Joehler Cathy Swift	Associate Commissioner for Fiscal Affairs Director of Budget and Accounting Chief Legal Counsel

Montana State University-All Campuses

Geoffrey Gamble Rolf Groseth Virginia Key	President Vice President of Intercampus Affairs Internal Auditor
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Montana State University-Bozeman

David Dooley Craig Roloff Thomas McCoy Thomas Gibson Leslie Taylor Laura Humberger Kathy Attebury	Provost and Vice President for Academic Affairs Vice President for Administration and Finance Vice President for Research and Creative Activities Treasurer Legal Counsel Controller Director of University Budgets
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Montana State University-Billings

Ronald P. Sexton Janie C. Park Curt Kochner Terrie Iverson LeAnn Anderson Jim Nielson Trudy Collins	Chancellor Provost and Academic Vice Chancellor Interim Vice Chancellor for Student Affairs Administrative Vice Chancellor Director of Financial Services Director of Business Services Budget Officer and Internal Audit
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Montana State University-Northern

Alex Capdeville Cheri Jimeno Chuck Jensen Carrie Molitor	Chancellor Interim Provost and Senior Vice Chancellor Vice Chancellor Finance & Administration/Student Affairs Controller
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*Ex officio member of the Board of Regents of Higher Education

Appointed and Administrative Officials

**Montana State University
College of Technology –
Great Falls**

Mary Moe
Mary Ellen Baukol
Ed Binkley

Dean
Assistant Dean for Business and Finance
Controller

**Montana Agricultural
Experiment Stations**

Jeffrey Jacobsen
Connie Shelhamer

Director
Budget & Fiscal Director

Montana Extension Service

Douglas Steele
Sandra Rahn-Gibson

Vice Provost and Extension Director
Budget and Fiscal Director

Members of the audit staff involved in this audit were John Fine, Paul J. O'Loughlin, Sonia Powell, and Vickie Rauser

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel



Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Consolidated Statement of Net Assets of Montana State University, a component unit of the state of Montana, as of June 30, 2004, and 2003, and the related Consolidated Statement of Revenues, Expenses and Changes in Net Assets and Consolidated Statement of Cash Flows for the fiscal years then ended and the University Component Units-Combined Statement of Financial Position as of June 30, 2004, and the related University Component Units-Combined Statement of Activities for the fiscal year then ended. The information contained in these financial statements is the responsibility of the university's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the university's aggregate discretely presented component units. Those statements include the Montana State University Foundation, the Museum of the Rockies Incorporated, the Montana State University-Billings Foundation, and the Montana State University-Northern Foundation, which represent 98.15 percent and 95.99 percent of the assets and revenues respectively of the total aggregate discretely presented component units and were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the audited component units of the university, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State University as of June 30, 2004, and 2003, and the results of its operations and its cash flows for the fiscal years then ended, and the financial position of the aggregate discretely presented component units as of June 30, 2004, and the related changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, for the period ending June 30, 2004 the university implemented Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, an amendment of GASB Statement No. 14.

The Management's Discussion and Analysis on pages A-3 through A-10 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Respectfully submitted,

(Signature on File)

James Gillett, CPA
Deputy Legislative Auditor

November 19, 2004

**Montana State University's
Management's Discussion and Analysis,
Financial Statements and Notes**

Montana State University
(a component unit of the State of Montana)
Management's Discussion and Analysis
As of and For Each of the Two Years Ended June 30, 2004

Montana State University is a modern, research- intensive land grant university that serves state, national and international communities by providing academic instruction, conducting research and other activities that advance fundamental knowledge, and by disseminating knowledge to the people of Montana. The University encompasses four campuses located in Bozeman, Billings, Great Falls and Havre, as well as the Montana Agricultural Experiment Station, Montana Extension Service and the Fire Services Training School. The University operates throughout Montana's 145,556 square miles of urban and rural communities housing a population of 918,000.

The University and its students are in a unique position. The number of high school graduates in Eastern Montana continues to decline, which has required the University to modify its mix of traditional in-state, out-of-state, and out-of-area students to ensure a diverse, growing student population. At the same time that the University's student makeup is changing, employee salary and benefit needs continue to grow, and the level of monetary support received from the State has not kept pace with increasing costs.

Given these significant changes, the University is proud to continue delivering quality services to a diverse student population, which is possible because of its dedicated faculty and staff, because its students recognize quality and value, and because accountability and the wise stewardship of University resources are simply a way of life.

OPERATIONS

Condensed Statements of Revenues, Expenses and Changes in Net Assets *(in millions)*

	2004		2003	
	Amount	% of Operating Revenues	Amount	% of Operating Revenues
Operating revenues	\$ 257.5	100.0%	\$ 242.3	100.0%
Operating expenses	342.4	133.0%	323.7	133.6%
Operating loss	(84.9)	(33.0%)	(81.4)	(33.6%)
Non-operating revenues and expenses (net)	88.9	34.5%	83.6	34.5%
Income before capital & other items	4.0	1.6%	2.2	0.9%
Capital & other items	8.6	3.3%	13.8	5.7%
Change in net assets	\$ 12.6	4.9%	\$ 16.0	6.6%

The ***Statement of Revenues, Expenses and Changes in Net Assets*** presents the revenues earned and expenses incurred during the year on a full accrual basis, and classifies activities as either "operating" or "non-operating." This distinction results in operating deficits for those institutions that depend on State aid and gifts, which are classified as non-operating revenue. The utilization of capital assets is reflected in the financial statements as depreciation expense, which allocates the cost of assets over their expected useful lives. The University's net

assets increased \$12.6 million during 2004, largely resulting from \$10.0 million in capital grants. Capital grant revenues include approximately \$2.9 million receivable from the Montana State University Foundation, dedicated to the construction of an agriculture research center.

Operating revenues contain the majority of the University's income, and increased \$15.2 million from 2003 to 2004, largely due to an increase in grant and contract-related revenues of approximately \$8.8 million, or 7.9%.

Montana State University
(a component unit of the State of Montana)
Management's Discussion and Analysis
As of and For Each of the Two Years Ended June 30, 2004

(continued)

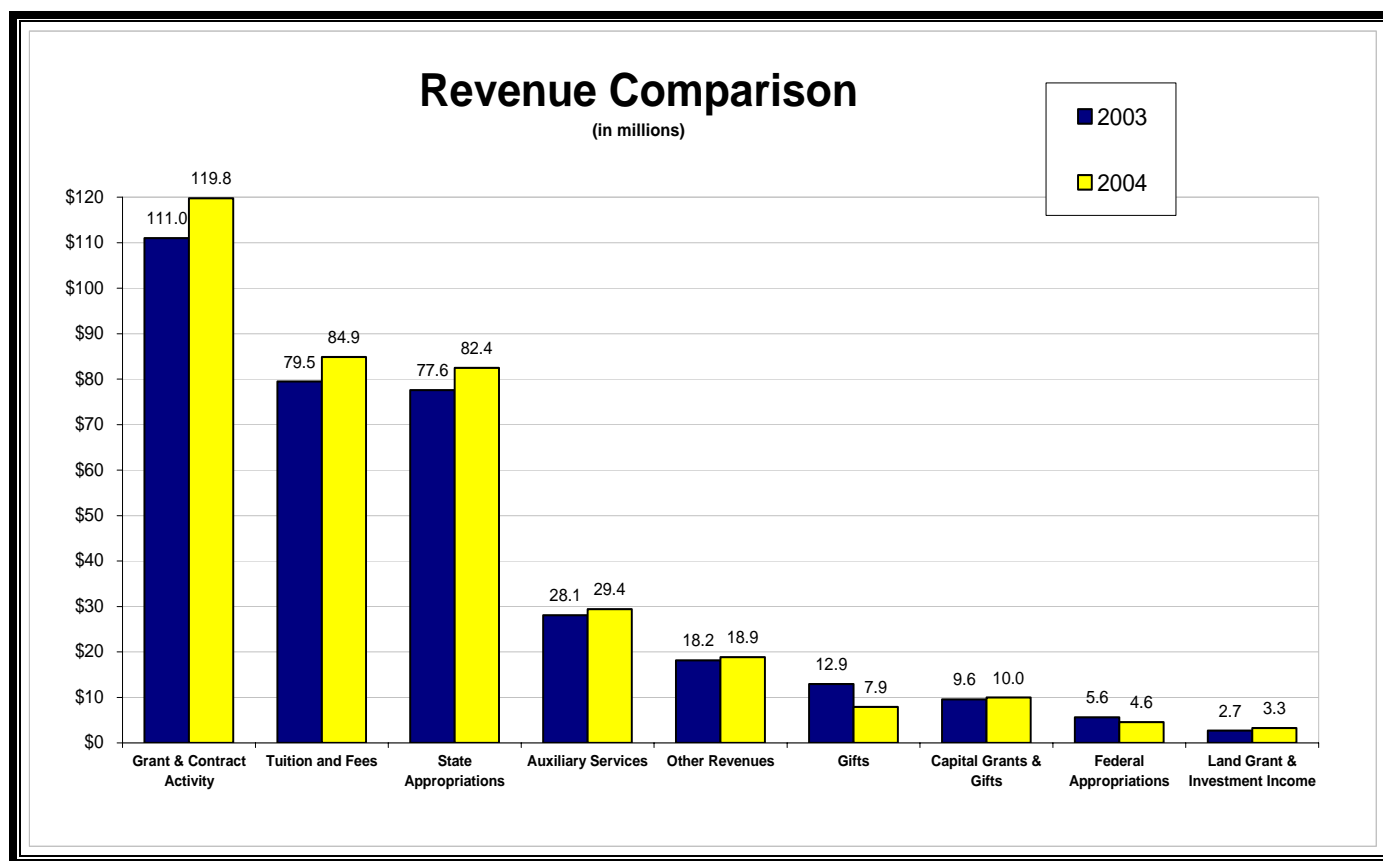
Grant and contract-related revenues include research grants funded by Federal, State and private sponsors, as well as over \$22 million in financial aid. The University maintains a vibrant Research and Creative Activities function that has experienced dramatic growth in the past year. These activities accounted for \$97.5 million in operating revenues during 2004.

Annual Student Enrollment Data (Full Time Equivalent)		
	2004	2003
Montana residents		
Undergraduate	13,380	13,130
Graduate	1,044	1,027
Non-residents		
Undergraduate	1,932	2,048
Graduate	276	269
Western Undergraduate Exchange	724	661
Total	17,356	17,135

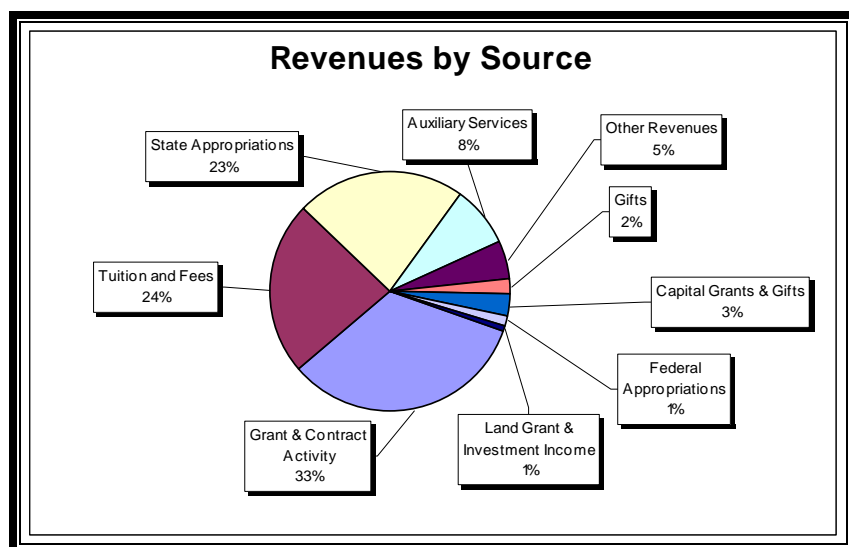
Tuition and fee revenues increased approximately \$5.4 million, or 6.7%. The University's freshman class has increased during each of the past several years. While the number of full-time equivalent students increased 1.3% compared with 2003, the primary reason for increased tuition and fee revenue was an approximate 11% average tuition increase.

State appropriations revenue, considered **non-operating revenue**, increased by \$4.8 million from \$77.6 million to \$82.4 million, or 6.2%. In 2003, the State made a mid-year budget reduction of \$6.7 million. Absent this reduction, the

2003 appropriation level would have been \$84.3 million. In 2004, the University was permitted to use \$2.5 million of its 2005 appropriation so that tuition increases could be evenly implemented during each year of the 2004-2005 biennium. Had this amount not been forward-funded, the 2004 appropriation would have been \$79.9 million. The rescission and decreased funding are reflective of difficult economic times recently faced by the State of Montana.



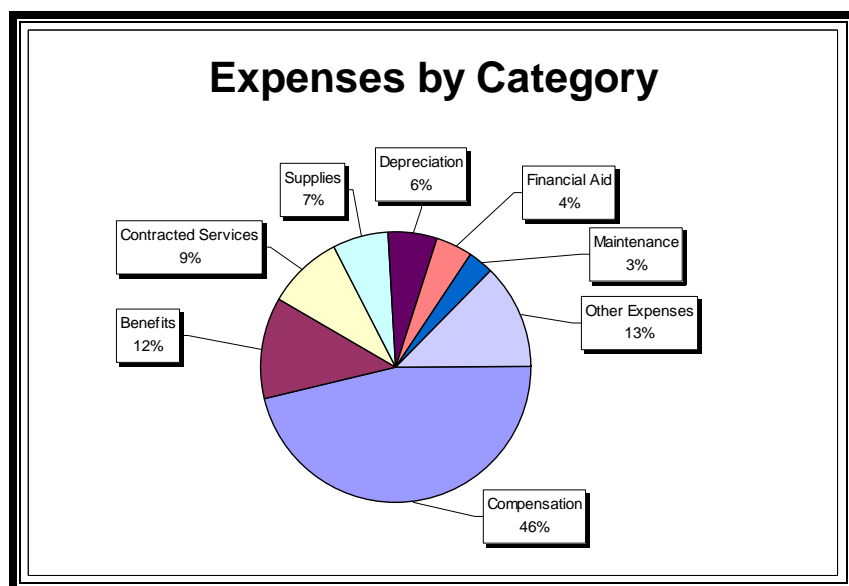
During 2004, revenues were derived as follows:



<i>(in millions)</i>	
Source	Amount
Grant & Contract Activity	\$ 119.8
Tuition and Fees	84.9
State Appropriations	82.4
Auxiliary Services	29.4
Other Revenues	18.9
Gifts	7.9
Capital Grants & Gifts	10.0
Federal Appropriations	4.6
Land Grant & Investment Income	3.3
Total revenues	\$ 361.2

Sources of recurring revenues are expected to remain strong, with a trend toward higher levels of University-generated revenues such as grant and contract activity, and other entrepreneurial activities.

Expenses were incurred as follows:



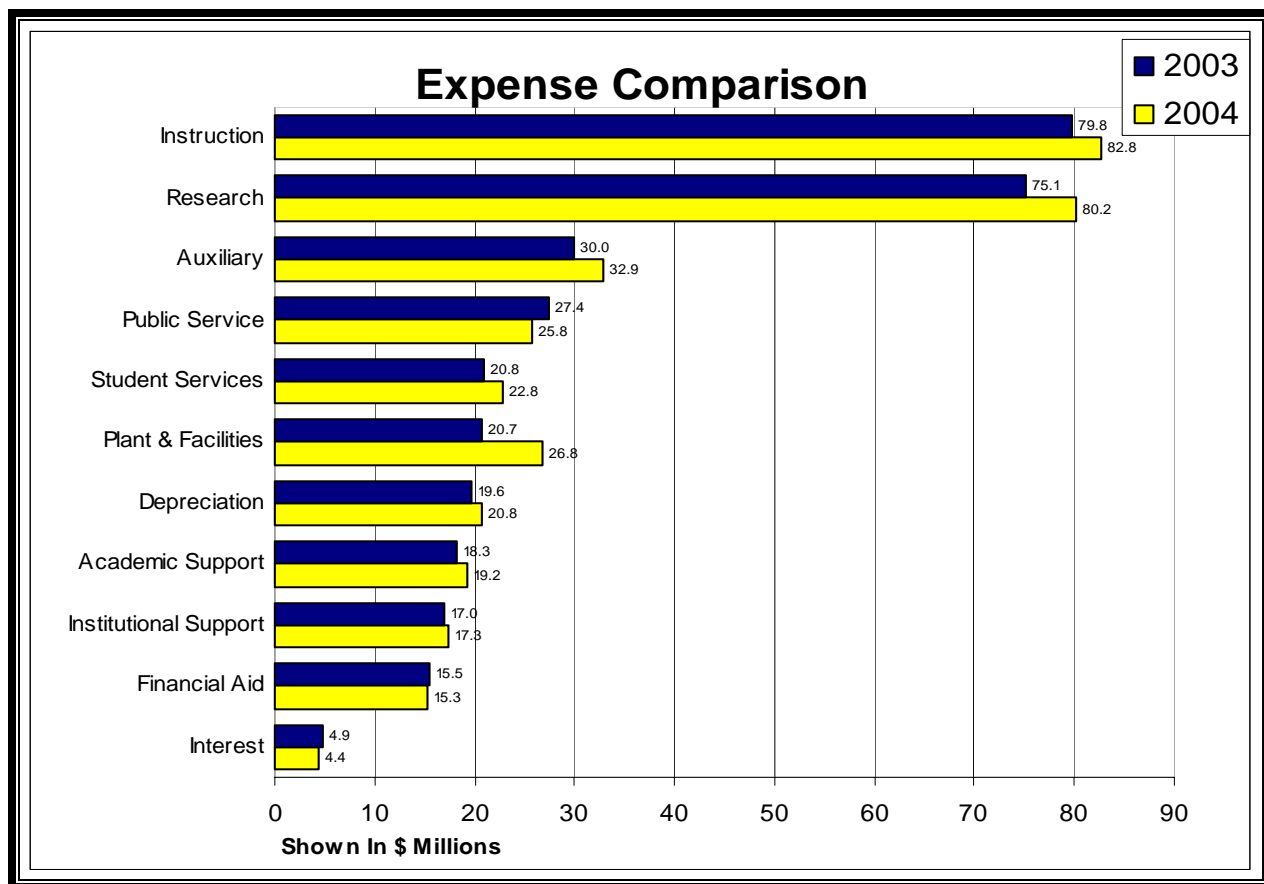
<i>(in millions)</i>	
Category	Amount
Compensation	\$ 160.3
Benefits	43.0
Contracted Services	32.3
Supplies	22.7
Depreciation	20.8
Financial Aid	15.3
Maintenance	10.0
Other Expenses	
Travel	9.3
Utilities	7.9
Cost of Sales	5.6
Communication	4.8
Interest Expense	4.4
Rent	2.8
Other	9.2
Total expenses	\$ 348.4

Proportions of revenues and expenses have generally remained constant as compared with prior years. Revenues are derived primarily from student charges, state appropriations and grant and contract activity, while expenses are primarily employee-related. These relationships are expected to continue.

Operating expenses increased \$18.7 million, and in each of the past two years represented 133% of operating revenues. Instruction and research activities together constitute approximately half of the University's expenses, and were two of the primary programs showing a marked increase, consistent with higher enrollment and a growing research program.

Plant and facilities expenses, the fourth-largest program, increased \$6.1 million, due to several factors. The cost of utilities used in the operation of classroom and administration facilities increased approximately \$1.0 million, and the write-off of development and design costs related to a canceled capital project contributed approximately \$800,000 in expense. Also during 2004, facilities staff performed more work on projects which were of a maintenance nature than in the prior year, in which significant staff time was spent on projects whose costs were capitalized and thus were not reflected in 2003 expenses.

The cost of providing auxiliary services, which consists primarily of dining and residence hall operations, constitutes the third largest cost category, and increased \$2.9 million due to the completion of certain deferred maintenance projects. Public service, which includes the activities of extension services throughout Montana as well as public television and radio stations and a regional museum, is the fifth largest program.



In the future, expenditures are expected to rise consistent with increases in research activity and increasing compensation costs. Financial aid expense is expected to increase commensurate with increases in the tuition rates, as the University strives to ensure continued access to all qualified students. Interest expense, considered a non-operating expense, is expected to increase as the University issues new debt to construct and renovate facilities.

ASSETS, LIABILITIES AND NET ASSETS

The **Statement of Net Assets** is presented in a classified format, which differentiates between current and non-current assets and liabilities, and also categorizes Net Assets (formerly called "Fund Balance") into four categories.

Condensed Statements of Net Assets (in millions)

ASSETS	2004	2003
Current assets	\$ 118.7	\$ 113.4
Capital assets, net	239.3	236.8
Other noncurrent assets	28.1	24.4
Total assets	\$ 386.1	\$ 374.6
LIABILITIES		
Current liabilities	\$ 49.9	\$ 48.9
Noncurrent liabilities	124.1	126.2
Total liabilities	\$ 174.0	\$ 175.1
NET ASSETS		
Invested in capital assets, net	\$ 147.7	\$ 143.3
Restricted, expendable	9.2	5.3
Restricted, non-expendable	9.8	9.3
Unrestricted	45.4	41.6
Total net assets	\$ 212.1	\$ 199.5

Current assets include the University's cash; accounts, grants and loans receivable; inventories; and other assets expected to benefit the University within one year. Accounts and grants receivable result primarily from sponsored projects that are payable on a cost-reimbursement basis, and also from student accounts. The increase of \$5.3 million in current assets resulted primarily from an increase of \$4.0 million in cash, which is discussed in detail in conjunction with the Statement of Cash Flows.

Capital assets, net increased \$2.5 million, resulting from asset additions of \$24.1 million, offset by depreciation expense of \$19.4 million and asset retirements of \$2.2 million. Increases included \$4.9 million in construction project additions, \$1.1 million of which was expended to replace the roof on MSU-Bozeman's fieldhouse and \$1.4 million expended for

MSU- Northern's Heating, Ventilation and Air-Conditioning system. Approximately \$3.5 million in library materials were added, \$2.3 million in buildings and improvements were recorded, and \$13.6 million in furniture and equipment were acquired. Furniture and equipment acquisitions included a \$2.1 million weightless space chamber and a digital satellite system for public television valued at nearly \$2 million. Other acquisitions related largely to the University's research and instruction programs, and included several donated and grant-funded items.

Other noncurrent assets include endowment fund assets, student loans receivable, investments expected to mature over a period longer than one year, and a donation receivable from the MSU Foundation which is restricted to the construction of a facility. The balance increased \$3.7 million, which included an increase of \$2.8 million in donations receivable and an increase of \$810,000 in noncurrent student loans receivable.

Current liabilities include payroll and related liabilities, amounts payable to suppliers for goods and services received, cash received for which the University has not yet earned the related revenue, and debt principal payments due within one year. The balance increased \$1.0 million, resulting primarily from the timing of expense payments near year-end in 2004 as compared with 2003, and the overall increase in expenditure levels.

Noncurrent liabilities include debt and advance liabilities, the amount of compensated absence liability estimated to be payable after a one-year period, and amounts which would be payable to the Federal government should the University choose to cease participation in the Federal Perkins Loan or Nursing Loan programs. These balances decreased \$2.1 million, due primarily to scheduled repayments of bond principal, offset by increased advances from the State under the InterCap lending program (see note 11).

Amounts **invested in capital assets, net of related debt**, consist of the historical acquisition value of capital assets, reduced by both accumulated depreciation expense charged against assets and debt balances related to

capital assets. This balance increases as assets are acquired and debt is repaid, and decreases as assets are depreciated and debt is incurred.

Restricted, expendable net assets represent balances that may be expended by the University, but only in accordance with restrictions imposed upon the University by an external party, such as a donor or through a legislative mandate. The University's most significant restricted, expendable balances relate to funds restricted to use for the construction, renewal or replacement of facilities. Approximately \$3.0 million is held by trustees in accordance with bond covenants, and may only be expended for the renewal and replacement of assets whose revenues are pledged as security for the repayment of debt. The remaining \$2.8 million relates to an amount receivable from the MSU Foundation, which is to be expended for the construction of a research facility.

Restricted, non-expendable balances must be held in perpetuity, and include endowment principal as well as the University portion of student loans receivable under the Federal Perkins and Nursing Loan programs.

Unrestricted net assets may be designated for specific purposes by action of management or the Board of Regents, or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for specific purposes as described in the notes to the financial statements, and include funds accumulated for employee termination payouts, funds earmarked for facility renewal and replacement, and student organization funds.

CASH FLOWS

Condensed Statements of Cash Flows (in millions)

	2004	2003
Cash provided/(used) by:		
Operating activities, net	\$ (65.8)	\$ (56.2)
Noncapital financing activities, net	92.6	92.1
Capital and related financing activities, net	(24.3)	(24.6)
Investing activities, net	1.5	(3.4)
Net increase in cash	4.0	7.9
Cash, beginning of year	82.8	74.9
Cash, end of year	\$ 86.8	\$ 82.8

The **Statement of Cash Flows** presents information related to cash inflows and outflows, categorized by operating, noncapital financing, capital financing, and investing activities. The reconciliation of operating loss to cash used in operations explains the relationship between the Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets, showing that increases and decreases in operating assets often require the use or receipt of cash, but do not result in recognition of a revenue or an expense.

A \$4.0 million increase in cash and equivalents was generated on \$4.0 million of "Income before other revenues, expenses, gains and losses" as reported in the accompanying Statement of Revenues, Expenses and Changes in Net Assets. During the prior year, a \$7.9 million increase in cash and equivalents was generated on \$2.3 million of "Income before other revenues, expenses, gains and losses." A year-to-year comparison of each type of cash flow follows.

Operating activities used \$65.8 million in cash, resulting primarily from an operating loss of \$84.9 million. The operating loss was offset by non-cash expenses of \$21.5 million, (primarily depreciation and amortization). Issuance of student loans outpaced the collection of loan repayments by \$1.5 million, resulting in a decreased cash balance. Other, less significant, increases and decreases also contributed to the change in operating cash.

In the prior year, operating activities used \$56.2 million in cash, resulting primarily from an operating loss of \$81.4 million. The operating loss was offset by non-cash expenses of \$20.5 million, (primarily depreciation and amortization) as well increased funds of \$4.7 million resulting from changes in operating assets and liabilities.

Noncapital financing activities provided \$92.6 million in cash, resulting from \$82.4 million in state appropriations, \$1.7 million of land grant income, and \$7.7 million of gift income. In the prior year, noncapital financing activities provided \$92.1 million in cash, resulting from \$77.6 million in state appropriations, \$1.6 million of land grant income, and \$8.3 million of gift income, as well as other, less significant sources and uses of cash.

Capital and related financing activities used \$24.2 million in cash, resulting primarily from \$18.0 million expended to acquire capital assets, \$19.6 million in bond issuance proceeds, \$22.5 million in debt principal payments (including refunded debt of \$18.1 million), and \$4.0 million in cash paid for interest, primarily related to bond indebtedness. In the prior year, these activities used \$24.6 million in cash, resulting from \$16.5 million expended to acquire capital assets, \$4.6 million in debt principal payments, and \$5.4 million in cash paid for interest.

Investing activities provided \$1.5 million, resulting from earnings on invested cash. In the prior year, investing activities used \$3.4 million. During 2003, cash of \$4.8 million, most of which had been received in the form of an estate gift, and was shown as a cash inflow in "Noncapital financing activities," was used to purchase long-term investments, and as such was considered a use of cash for investing purposes. This use of cash was offset by investment earnings of \$1.2 million.

BONDS, NOTES, AND CAPITAL LEASES

As of June 30, 2004, the University had approximately \$87.3 million in outstanding bonds, notes, and capital lease principal, a decrease of \$3.1 million compared with June 30, 2003. The change resulted from new borrowings of \$19.6 million, amortization of \$590,000 in discount and issue costs, offset by payment of \$817,000 in bond issue costs, and repayments of \$22.5 million.

New borrowings included the October 2003 issuance of \$18.8 million in Municipal Auction Rate Securities as Series 2003 G Revenue Bonds. Of this total, \$16,745,000 was used for a current refunding of the Series 1993-A bonds and \$2,015,000 was used for an advance refunding of the Series 1994 C bonds. The new bonds are ten year variable rate bonds, priced on a 35-day rate period. They are unconditionally and irrevocably guaranteed by XL Capital Assurance. The bonds were issued in denominations of \$25,000, with principal repayments scheduled each May 15 and November 15 through November, 2016. The effective interest rate on these variable rate bonds has ranged from 0.8% to 1.65% since the date of issuance. Interest is paid monthly based on the Auction Rate. The University has set aside an amount equal to a 3.25% effective rate each month, and will use any reserves generated in times of low rates to supplement payments in times of rising rates.

Subsequent to June 30, 2004, the University entered into or plans to execute certain debt transactions as follows.

In November 2004, the University issued \$23.7 million as Series H revenue bonds, the proceeds of which will be used to construct a Chemistry/Biochemistry Research Laboratory Facility on the campus of Montana State University-Bozeman. The traditional fixed rate issue carries an effective interest rate of 4.61% and a 30-year repayment term. Indirect cost recoveries derived from the University's Research and Creative Activities will be added to the existing pledged revenues of the University's bonded indebtedness and will be used to fund debt service requirements.

Also in November, the Board of Regents authorized the issuance of Series I 2004 Facilities Revenue Refunding Bonds to refund a significant portion of the Series D 1996 bonds currently outstanding. The bonds, maturing in

November 2025, are expected to be issued at a face value of \$31.48 million and result in a calculated savings of approximately \$1.8 million over the repayment period

Enhancement of student facilities at the Bozeman campus has been approved by the Board of Regents in the amount of \$28.0 million. Enhancements include renovation of the student union building, construction of a theater, and renovation of the health and P.E. complex. The University plans to issue bonds to fund approximately \$25.0 million of the project, with the use of existing resources funding the remainder. Increased student fees will be implemented beginning in the Fall of 2005, and will be pledged for the repayment of these bonds, which are expected to be issued early in 2005.

ECONOMIC OUTLOOK

The State of Montana has experienced economic uncertainty, which affects the University's level of available State funding. The State of Montana Legislative Fiscal Division has prepared a *General Fund Preliminary Budget Outlook 'Big Picture Report' 2007 Biennium*. The report discusses "structural balance" as the matching of *ongoing* revenues with *ongoing* expenditures. In the recent past, the University has strived to achieve structural balance by combining controlled spending with increased revenues, to maintain quality programs in light of flat or decreased available State funding.

Recent revenue increases have been achieved through several means: the growth of grant and contract activity; increases in tuition rates charged to students, which will likely continue at a steady, predictable level; careful monitoring and management of the mix of in-state and out-of-state students, whose tuition rates differ; and continued encouragement of the entrepreneurial spirit maintained by many University faculty and staff.

The "Big Picture Report" discusses the comparatively brighter budget projections for the upcoming biennium than has been faced by the State in the recent past, citing strong growth in individual income tax and oil and gas tax revenues as primary factors. A strong ending fund balance and the ability to fund several one-time projects are expected. As always, there are a number of issues, including ballot initiatives, litigation issues, and other items, with uncertain or unknown impact that are not included in current budget projections.

The U.S. Census Bureau projects that, over the next twenty years, the population of Montanans ages 18 – 24 will decrease steadily, showing an approximate 10% overall decrease. In light of this trend, continued monitoring and management of the University's out-of-state student population and tuition rates is crucial.

To assist in the allocation of its resources, management evaluates University programs regularly, and maintains a budgeting process that is open to the public. Accountability and stewardship of the University's assets are stressed by top management, as is excellence in the programs offered. University management will continue to determine the proper balance between spending cuts and revenue increases, to ensure that quality programs remain while access to the University is not unduly limited by the cost of attendance.

Montana State University
a component unit of the State of Montana
Consolidated Statements of Net Assets
As of June 30

ASSETS	2004	2003
Current assets:		
Cash and cash equivalents	\$ 85,897,298	\$ 81,895,206
Accounts and grants receivable, net	5,935,449	7,203,919
Amounts receivable from Federal government	15,350,504	13,303,535
Amounts receivable from primary government	1,190,805	1,159,718
Amounts receivable from other State of Montana Component Units	146,710	22,326
Loans receivable, net	4,232,045	4,228,273
Inventories	2,832,718	3,009,439
Prepaid expenses and other current assets	3,179,666	2,597,090
Total current assets	118,765,195	113,419,506
Noncurrent assets:		
Restricted cash and cash equivalents	941,704	940,586
Restricted investments	5,396,299	5,133,614
Loans receivable, net	17,033,357	16,223,813
Investments	1,933,431	2,141,975
Other assets	2,775,858	-
Capital assets, net (see note 7)	239,316,813	236,768,452
Total noncurrent assets	267,397,462	261,208,440
Total assets	\$ 386,162,657	\$ 374,627,946
LIABILITIES		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 23,026,240	\$ 21,906,619
Amounts payable to primary government	1,247,450	1,648,671
Amounts payable to other State of Montana component units	20,934	338,381
Property held in trust for others	1,237,654	876,175
Deferred revenues	8,360,313	8,971,103
Compensated absences	11,081,843	10,642,125
Current portion debt and capital lease obligations (note 10)	4,965,455	4,552,141
Total current liabilities	49,939,889	48,935,215
Noncurrent liabilities:		
Advances from primary government	8,785,996	7,769,759
Debt and capital lease obligations (note 10)	82,351,350	85,903,743
Compensated absences	12,176,957	12,254,032
Due to Federal government	20,771,691	20,254,326
Total noncurrent liabilities	124,085,994	126,181,860
Total liabilities	174,025,883	175,117,075
NET ASSETS		
Invested in capital assets, net of related debt	147,763,170	143,300,755
Restricted - nonexpendable:		
Endowments	6,338,003	6,074,199
Loans	3,425,954	3,267,052
Restricted - expendable:		
Scholarships	824,666	297,961
Research and other	2,445,913	1,430,603
Loans	167,636	189,365
Renewal and replacement of plant facilities	5,771,107	3,045,471
Debt retirement	23,952	321,754
Unrestricted (note 13)	45,376,373	41,583,711
Total net assets	212,136,774	199,510,871
Total liabilities and net assets	\$ 386,162,657	\$ 374,627,946

The accompanying notes are an integral part of these financial statements.

Montana State University
a component unit of the State of Montana

UNIVERSITY COMPONENT UNITS-- Combined Statement of Financial Position
As of June 30, 2004 or December 31, 2003 (see Note 20)

Assets:

Cash and cash equivalents	\$ 6,443,381
Accrued dividends and interest	53,869
Investments	107,901,455
Amounts due from the institution or other component units	817,648
Contributions receivable, net of allowance	5,895,303
Contracts, notes and other receivables	113,646
Student loans and other receivables	872,014
Non-depreciable capital assets	783,109
Depreciable capital assets, net	6,033,789
Other assets	2,299,030

Total assets	\$ 131,213,244
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Liabilities and net assets:

Liabilities

Accounts payable	\$ 571,109
Accrued expenses and other liabilities	1,367,399
Compensated absences	95,535
Notes and bonds payable	2,734,731
Amounts due to the institution or other component units	3,504,384
Liabilities to external beneficiaries	3,147,064
Custodial funds	8,778,795
Total liabilities	20,199,017

Unrestricted net assets	12,484,250
Temporarily restricted net assets	31,020,115
Permanently restricted net assets	67,509,862
Total net assets	111,014,227

Total liabilities and net assets	\$ 131,213,244
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The accompanying notes are an integral part of these financial statements.

Montana State University

a component unit of the State of Montana

Consolidated Statements of Revenues, Expenses and Changes in Net Assets

As of and for Each of the Two Years Ended June 30

	2004	2003
OPERATING REVENUES		
Tuition and fees (net of \$17,326,412 and \$17,223,007 scholarship discount); (\$5,426,006 and \$5,232,010 are pledged for repayment of bonds)	\$ 84,852,818	\$ 79,491,455
Federal appropriations	4,562,318	5,621,121
Federal grants and contracts	89,330,062	81,012,750
State grants and contracts	7,508,336	6,396,530
Non-governmental grants and contracts	8,828,330	9,999,146
Grant and contract facilities and administrative cost allowances	14,110,253	13,568,037
Educational, public service and outreach revenues (\$2,959,480 and \$2,673,980 are pledged for repayment of bonds)	18,302,474	17,005,161
Auxiliary revenues:		
Housing (net of \$1,314,925 and \$1,223,419 scholarship discount),(\$ 2,119,122 and \$1,988,360 net revenues are pledged for repayment of bonds)	11,135,119	11,116,267
Food services (net of \$1,532,249 and \$1,320,205 scholarship discount), (\$1,388,797 and \$2,241,740 net revenues are pledged for repayment of bonds)	10,856,444	10,340,616
Other auxiliary sales and services (net of \$572,653 and \$1,271,273 scholarship discount), (\$380,081 and \$70,026 net losses are pledged for repayment of bonds)	7,430,793	6,630,123
Interest earned on loans	54,301	85,542
Other operating revenues	496,216	1,080,765
Total operating revenues	257,467,464	242,347,513
OPERATING EXPENSES		
Compensation and benefits	203,327,304	194,696,126
Operating expenses (Note 14)	102,936,542	93,906,338
Scholarships and fellowships (net of \$20,746,239 and \$21,037,904 scholarship discount)	15,312,605	15,501,298
Depreciation and amortization	20,803,902	19,627,347
Total operating expenses	342,380,353	323,731,109
Operating loss	(84,912,889)	(81,383,596)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	82,435,945	77,594,407
Land grant income (pledged as security for repayment of bonds)	1,706,447	1,551,616
Gifts (expendable)	7,696,004	8,255,689
Investment income (\$184,216 and \$276,074 are pledged as repayment of bonds)	1,544,840	1,132,768
Interest expense	(4,460,697)	(4,897,408)
Net nonoperating revenues (expenses)	88,922,539	83,637,072
Income before other revenues, expenses, gains and losses	4,009,650	2,253,476
Gain (loss) on disposals of capital assets	(1,585,269)	(457,354)
Additions to permanent endowment	229,730	4,667,033
Capital gifts, grants and contributions	9,971,792	9,595,433
Change in net assets	12,625,903	16,058,588
Net assets, beginning of year, as previously stated	199,510,871	188,871,091
Adjustment to advance from primary government	-	(5,418,808)
Net assets, beginning of year, as restated	199,510,871	183,452,283
Net assets, end of year	\$ 212,136,774	\$ 199,510,871

The accompanying notes are an integral part of these financial statements.

Montana State University
a component unit of the State of Montana

UNIVERSITY COMPONENT UNITS-- Combined Statement of Activities
As of and for the Year Ended June 30, 2004 or December 31, 2004 (see Note 20)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:				
Contributions	\$ 1,063,898	\$ 7,084,225	\$ 5,484,779	\$ 13,632,902
Investment, interest and dividend income	1,544,826	6,406,281	577,117	8,528,224
Net realized and unrealized gain (loss) on investments	135,816	575,443	16,134	727,393
Support received from university	1,496,745	23,855	-	1,520,600
Special events	260,237	-	-	260,237
Other income	3,941,514	454,167	127,835	4,523,516
Net assets released from restrictions	7,731,879	(7,723,329)	(8,550)	-
Total revenues	16,174,915	6,820,642	6,197,315	29,192,872
Expenses:				
Program services				
University support	6,996,806	-	-	6,996,806
Academic and institutional	2,233,006	-	-	2,233,006
Scholarships and awards	1,106,075	-	-	1,106,075
Total program services expense	10,335,887	-	-	10,335,887
Operating expenses				
Fundraising efforts	1,733,148	-	-	1,733,148
General and administrative	1,677,268	-	-	1,677,268
Investment management costs	81,619	-	-	81,619
Other miscellaneous	1,011,694	-	109,712	1,121,406
Total operating expenses	4,503,729	-	109,712	4,613,441
Change in net assets before nonoperating items	1,335,299	6,820,642	6,087,603	14,243,544
Non-operating expenses				
Other nonoperating expenses	(80,000)	-	-	(80,000)
Payments to beneficiaries and change in liabilities due to external beneficiaries	(27,506)	-	-	(27,506)
Change in net assets	1,227,793	6,820,642	6,087,603	14,136,038
Net assets, beginning of fiscal year	11,256,457	24,199,473	61,422,259	96,878,189
Net assets, end of fiscal year	\$ 12,484,250	\$ 31,020,115	\$ 67,509,862	\$ 111,014,227

The accompanying notes are an integral part of these financial statements.

Montana State University
a component unit of the State of Montana
Consolidated Statements of Cash Flows
As of and For the Year Ended June 30

	2004	2003
Cash flows from operating activities:		
Operating revenues:		
Tuition and fees	\$ 84,200,737	\$ 79,146,224
Federal appropriations	4,894,423	5,289,016
Federal grants and contracts	86,917,211	80,126,424
State grants and contracts	6,893,965	7,971,921
Private grants and contracts	10,290,760	9,474,104
Indirect cost recoveries	14,017,462	13,450,989
Educational, public service and outreach revenues	19,484,885	17,552,426
Sales and services of auxiliary enterprises	29,519,473	28,120,760
Interest on loans receivable	649,007	527,610
Other operating receipts	496,216	1,080,765
Operating expenses:		
Compensation and benefits	(202,502,845)	(191,613,330)
Operating expenses	(104,579,505)	(92,487,781)
Scholarships and fellowships	(15,312,605)	(15,501,298)
Loans made to students	(4,928,354)	(3,201,999)
Loan payments received	4,135,087	3,868,109
Net cash used in operating activities	(65,824,083)	(56,196,060)
Cash flows from noncapital financing activities:		
Receipts of funds held in trust for others	518,835	64,750
Direct lending proceeds	62,582	35,716,447
Direct lending disbursements	(62,582)	(35,716,447)
State appropriations	82,435,946	77,594,407
Gifts and contributions (expendable)	7,696,005	8,255,689
Land grant income (Note 2)	1,706,447	1,551,616
Additions to permanent endowment	229,730	4,667,033
Net cash provided by noncapital financing activities	92,586,963	92,133,495
Cash flows from capital financing activities:		
Purchase of capital assets	(17,951,302)	(16,452,831)
Proceeds from sale of capital assets	92,502	128,031
Proceeds from borrowings	19,552,969	680,169
Debt repayment	(22,450,185)	(4,560,990)
Interest paid	(4,004,438)	(5,410,680)
Capital gifts, grants and contributions	128,000	-
Payment of debt issue costs	(816,879)	-
Advances from primary government	1,943,485	983,803
Repayment of advances from primary government	(744,522)	-
Net cash used in capital financing activities	(24,250,370)	(24,632,498)
Cash flows from investing activities:		
Purchase of investments	(449,122)	(4,774,493)
Proceeds from sale of investments	394,980	151,145
Investment income	1,544,842	1,238,717
Net cash provided by (used in) investing activities	1,490,700	(3,384,631)
Net change in cash and cash equivalents	4,003,210	7,920,306
Cash balances at beginning of year	82,835,792	74,915,486
Cash balances at end of year	\$ 86,839,002	\$ 82,835,792

The accompanying notes are an integral part of these financial statements.

Montana State University*a component unit of the State of Montana***Consolidated Statements of Cash Flows (continued)****As of and For the Year Ended June 30****Reconciliation of Operating Loss to Net Cash Used in Operations**

	2004	2003
Operating loss	\$ (84,912,889)	\$ (81,383,596)
Non-cash income and expense:		
Depreciation and amortization	20,803,902	19,627,347
Provision for uncollectible accounts	649,222	836,440
Changes in operating assets and liabilities:		
Accounts and grants receivable	(1,620,147)	(534,614)
Loans receivable	(793,269)	666,110
Inventories	176,721	(133,346)
Prepaid expenses	(582,575)	(411,772)
Accounts payable and other accrued liabilities	185,731	2,987,426
Deferred revenue	(610,788)	485,275
Compensated absences	362,645	1,222,602
Due to federal government	517,364	442,068
Net cash used in operating activities	\$ (65,824,083)	\$ (56,196,060)

Schedule of noncash financing and investing activities

	2004	2003
Capital assets contributed to the University	\$ 7,067,935	\$ 9,595,433
Capital assets acquired through issuance of capital lease obligations	\$ 10,796	\$ 113,982
Bond discount amortized to interest expense	\$ 508,590	\$ 482,230
Bond issue costs amortized to interest expense	\$ 81,688	\$ -

Reconciliation of cash and cash equivalents as shown on the Statements of Cash Flows to Cash as Shown in the Statements of Net Assets

	2004	2003
Cash and cash equivalents classified as current assets	\$ 85,897,298	\$ 81,895,206
Cash and cash equivalents classified as non-current assets	941,704	940,586
Total cash and cash equivalents as reported on the Statements of Cash Flows	\$ 86,839,002	\$ 82,835,792

The accompanying notes are an integral part of these financial statements.

Montana State University
(a component unit of the State of Montana)
Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2004
(continued)

NOTE 1 – ORGANIZATION, BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

The accompanying financial statements include all activities of the four Montana State University campuses, the Montana Agricultural Experiment Station, Montana Extension Service and the Fire Services Training School, collectively referred to as the "University." The four campuses of the University are Montana State University–Bozeman, Montana State University–Billings, Montana State University–Northern (located in Havre) and Montana State University College of Technology–Great Falls. Significant interagency transactions have been eliminated in consolidation.

The University is a modern research intensive land grant university that serves the state, national and international communities by providing its students with academic instruction, conducting research and other activities that advance fundamental knowledge, and by disseminating knowledge to the people of Montana.

A financial reporting entity, as defined by Governmental Accounting Standards Board ("GASB") Statement No. 14, *The Financial Reporting Entity*, consists of the primary government, organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion could cause the financial statements to be misleading or incomplete. Accordingly, the financial statements for the University are included as a component unit of the State of Montana Basic Financial Statements, which are prepared annually and presented in the Montana Comprehensive Annual Financial Report (CAFR).

In May 2002, the Governmental Accounting Standards Board (GASB) issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units, an Amendment of GASB Statement No. 14*. The University was required to adopt the statement as of and for the year ended June 30, 2004. The statement requires that a legally tax exempt organization should be reported as a component unit of a reporting entity if the economic resources received or held by these organizations are entirely or virtually entirely for the direct benefit of the reporting entity or its component units, and the reporting entity is entitled to, or has the means to otherwise access, a majority of the economic resources received or held by the separate organization. The resources of the separate organization must also be significant to the reporting entity. In addition, other organizations should be evaluated for inclusion if they are closely related to, or financially integrated with, the reporting entity. The University has established a threshold minimum of 1% - 2% percent of consolidated net assets or 1% - 2% percent of consolidated revenues as an initial requirement for inclusion of an organization as a component unit in its financial statements. Other entities may be included, though, if the University determines that to exclude the entity would be misleading. All component units and other related organizations will be tested and evaluated on an annual basis for inclusion under GASB No. 39. For further discussion of component units, see Note 20.

BASIS OF PRESENTATION

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*. This was followed in November, 1999 by GASB Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*. The State of Montana implemented GASB Statement No. 34 as of and for the year ended June 30, 2003. As a component unit of the State of Montana, the University was also required to adopt GASB Statements No. 34 and No. 35. The latter statement was adopted as amended by GASB Statements No. 37 and No. 38. During the year ended June 30, 2002, the University also adopted GASB Statement No. 33, *Accounting and Financial Reporting for Non-Exchange Transactions*.

The financial statement presentation required by GASB Statements No. 34 and No. 35 provides a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues,

Montana State University
(a component unit of the State of Montana)
Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2004
(continued)

expenses, changes in net assets, and cash flows, and replaces the fund-group perspective previously required.

Significant accounting changes that were made to comply with the new requirements included (1) adoption of depreciation on capital assets and capitalizing infrastructure assets; (2) allocating summer school revenues and expenses among fiscal years rather than reporting each summer in one fiscal year; (3) reporting of tuition and fees and other student revenues, as well as scholarship and fellowship expense, net of scholarship discounts and allowances; and (4) deferring the recognition of grant or contract revenue until funds received have been expended for their restricted purpose.

For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Business-type activities are those that are financed in whole or in part by fees charged to external parties for goods or services. Accordingly, the University's financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. The University has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The State of Montana has elected not to apply FASB pronouncements issued after the applicable date.

SIGNIFICANT ACCOUNTING POLICIES

Cash equivalents – For purposes of the statement of cash flows, the University considers its unrestricted, highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Funds invested in the Short Term Investment Pool with the Montana Board of Investments are considered cash equivalents, as are certain investments held by trustees.

Investments – The University accounts for its investments at fair value in accordance with GASB Statement No. 31 *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Investment income is recorded on the accrual basis. All investment income, including changes in unrealized gain (loss) on the carrying value of investments, is reported as a component of investment income.

Accounts and grants receivable – Accounts receivable consist of tuition and fees charged to students and auxiliary enterprise services provided to students, faculty and staff. Accounts receivable also include amounts due from the Federal government, state and local governments, or private sources, in connection with reimbursement of allowable expenditures made pursuant to the University's grants and contracts. Accounts receivable are reported net of estimated uncollectible amounts.

Allowances for uncollectible accounts – The University estimates the value of its receivables that will ultimately prove uncollectible, and has reported a provision for such as an expense in the accompanying financial statements.

Inventories – Inventories include consumable supplies, livestock, and food items and items held for resale or recharge within the University. Inventories are valued using First In First Out (FIFO) or specific identification methods.

Non-current cash and investments – Cash and investments that are externally restricted as to use are classified as non-current assets in the accompanying statement of net assets. Such assets include endowment fund cash and investments.

Capital assets – Capital assets are stated at cost or fair value at date of purchase or donation. Livestock held for educational purposes is recorded at estimated fair value. Renovations to buildings, infrastructure, and land improvements that significantly increase the value or extend the useful life of the structure are

Montana State University
(a component unit of the State of Montana)
Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2004
(continued)

capitalized. Routine repairs and maintenance and minor renovations are charged to operating expense in the year in which the expense is incurred.

Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the respective assets, ranging from 3 years for certain software to 75 years for certain infrastructure assets. The University has elected to capitalize museum, fine art and special library collections, but does not record depreciation on those items.

Deferred revenues – Deferred revenues include amounts received for tuition and fees and certain auxiliary activities prior to the end of the fiscal year but related to events occurring in the subsequent accounting period. Deferred revenues also include amounts received from grant and contract sponsors that have not yet been earned.

Compensated absences – Eligible University employees earn a minimum of 8 hours sick and 10 hours annual leave for each month worked. Eligible employees may accumulate annual leave up to twice their annual accrual, while sick leave may accumulate without limitation. Twenty-five percent of accumulated sick leave earned after July 1, 1971 and 100 percent of accumulated annual leave, if not used during employment, is paid upon termination.

Net assets – Resources are classified in one of the following four net asset categories:

Invested in capital assets, net of related debt – this represents the University's total investment in capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

Restricted net assets, nonexpendable – this represents net assets subject to externally imposed stipulations that the University maintain those assets permanently. Such assets include the University's permanent endowment funds.

Restricted net assets, expendable – this represents net assets whose use by the University is subject to externally imposed stipulations as to either the use or the period of availability of the assets.

Unrestricted net assets – this represents net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Regents or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for specific purposes as described in Note 13.

Classification of revenues – The University has classified its revenues as either operating or non-operating according to the following criteria:

Operating revenues – include activities that have the characteristics of exchange transactions, including (1) student tuition and fees, net of scholarship discounts and allowances, (2) sales and services of auxiliary enterprises, net of scholarship discounts and allowances, (3) most Federal, state and local grants and contracts and Federal appropriations, and (4) interest on institutional student loans.

Non-operating revenues – include activities that have the characteristics of non-exchange transactions, such as gifts and contributions, and other revenue sources that are defined as non-operating revenues by GASB No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB No. 34, such as state appropriations and investment income.

Montana State University
(a component unit of the State of Montana)
Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2004
(continued)

Use of restricted revenues – When the University maintains both restricted and unrestricted funds for the same purpose, the order of use of such funds is determined on a case-by-case basis. Restricted funds remain classified as restricted until they are expended.

Income taxes – The University, as a political subdivision of the State of Montana, is excluded from Federal income taxes under Section 115(1) of the Internal Revenue Code, as amended. Certain activities of the University may be subject to taxation as unrelated business income under Internal Revenue Code Sections 511 to 514. Because tax liabilities are not considered to be material, no provision for income tax expense is reported in the accompanying financial statements.

Scholarship discounts and allowances – Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are computed as the difference between the stated charge for goods and services provided by the University, and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants, and other Federal, state or nongovernmental programs, are recorded as operating revenues in the University's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the University has recorded a scholarship discount and allowance.

Adjustments and Reclassifications – Certain prior year amounts have been adjusted or reclassified. Specifically, contributions to permanent endowments are now shown separately from expendable gifts, and advances from the primary government are shown separately from other long-term obligations. An adjustment of \$5,418,808 was made to beginning fund balance upon the recording of an advance payable to the primary government. Advances had been incorrectly recorded as revenue upon receipt, primarily during 1994.

NOTE 2 –CASH EQUIVALENTS, AND INVESTMENTS

Cash equivalents – These amounts consist of cash held by trustees as well as in the Short Term Investment Pool (STIP) with the Montana Board of Investments. STIP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle." The STIP portfolio may include asset-backed securities, banker's acceptances, certificates of deposit, commercial paper, corporate and government securities, repurchase agreements and variable rate securities to provide diversification and a competitive rate of return. Cash equivalents are classified as Risk Category #1.

Investments – The University's investments are categorized as to credit risk as either Category I insured or registered, or securities held by the University or its agent in the University's name, or other investments not categorized.

Fair Value of Cash Equivalents and Investments as of June 30,

	<u>2004</u>	<u>2003</u>
Category I -		
U.S. Government securities	\$ 39,120,068	\$ 47,149,868
Not Categorized -		
Foundation Pools	5,396,299	4,979,430
Total Cash Equivalents and Investments	<u>\$ 44,516,367</u>	<u>\$ 52,129,298</u>

The cost basis of investments held by the State of Montana Board of Investments was \$36,140,723 and \$44,128,521 as of June 30, 2004 and 2003. The cost basis of investments held by trustees was \$8,351,305 and \$7,883,493 as of June 30, 2004 and 2003.

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Asset-backed securities are collateralized by non-mortgage assets pledged by the issuer and have one or more forms of credit enhancement to raise the quality of the security.

The Foundation Pool consists of certain endowment funds held in common investment pools administered by the MSU-Bozeman and MSU-Northern Foundations.

Securities lending transactions – Under the provisions of state statutes, the Board of Investments has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the market value of the loaned securities and maintain collateral equal to not less than 100 percent of the market value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years ending June 30, 2004 and 2003, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. As of June 30, 2004 and 2003, the board had no credit risk exposure to borrowers, and the University maintained no security lending cash collateral.

Land grant earnings – The University benefits from two separate land grants, totaling 240,000 acres. The first granted 90,000 acres for the University under provisions of the Morrill Act of 1862. The second, under the Enabling Act of 1889, granted an additional 50,000 acres for agricultural institutions and 100,000 acres for state normal schools.

Under provisions of both grants, income from the sale of land and land assets must be reinvested and constitutes, along with the balance of the unsold land, a perpetual endowment fund. The State of Montana, Board of Land Commissioners, administers both grants and holds all endowed assets. The University's land grant assets are not reflected in these financial statements, but are included as a component of the State of Montana Basic Financial Statements that are prepared annually and presented in the Montana CAFR.

Investment income from the perpetual endowment is distributed periodically to the University by the State of Montana, Board of Land Commissioners, and is reported as revenue in the accompanying financial statements. The University has currently pledged such income to the retirement of revenue bond indebtedness.

In addition to distributed endowment income, the University also receives revenue generated from trust land timber sales. The University has designated these revenues for re-investment, but has the flexibility to remove this designation, should it choose to expend the funds for certain specified purposes.

Off-balance sheet risk – The University's investment strategy incorporates certain financial instruments that involve, to varying degrees, elements of market risk and credit risk in excess of amounts reported in the financial statements. Market risk is the potential for changes in the value of financial instruments due to market changes, including interest and foreign exchange rate movements and fluctuations embodied in forward, futures, commodity or security prices. Market risk is directly impacted by the volatility and liquidity of the markets in which the related underlying assets are traded. Credit risk is the possibility that a loss may occur due to the failure of a counter party to perform according to the terms of the contract. The University's risk of loss in the event of counter party default is limited to the amounts recognized in the statement of net assets.

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NOTE 3 – ACCOUNTS AND GRANTS RECEIVABLE

Accounts receivable consisted of the following as of June 30:

	2004	2003
Accounts receivable	\$ 5,088,174	\$ 4,523,521
Other receivables, including private grants and contracts	2,773,336	4,441,961
Gross accounts and grants receivable	7,861,510	8,965,482
Less allowance for uncollectible accounts	(1,926,061)	(1,761,563)
Net accounts and grants receivable	<u>\$ 5,935,449</u>	<u>\$ 7,203,919</u>

NOTE 4 – INVENTORIES

Inventories consisted of the following as of June 30:

	2004	2003
Bookstore	\$ 1,048,589	\$ 1,138,685
Food services	268,707	299,154
Facilities services	248,432	227,550
Livestock	519,225	672,610
Other	747,765	671,440
Total inventories	<u>\$ 2,832,718</u>	<u>\$ 3,009,439</u>

NOTE 5 – PREPAID EXPENSES

Prepaid expenses consisted of the following as of June 30:

	2004	2003
Leases	\$ 50,000	\$ 100,000
Library subscriptions	1,374,535	1,356,300
Other	1,755,131	1,140,790
Total prepaid expenses	<u>\$ 3,179,666</u>	<u>\$ 2,597,090</u>

NOTE 6 – LOANS RECEIVABLE

Student loans made under the Federal Perkins Loan Program constitute the majority of the University's loan balances. Included in non-current liabilities as of June 30, 2004 and 2003 are \$20,771,691 and \$20,254,326 that would be refundable to the Federal Government, should the University choose to cease participation in the Federal Perkins Loan program.

The Federal portions of interest income and loan program expenses are shown as additions to and deductions from the amount due to the Federal government, and not as operating transactions, in the accompanying financial statements.

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NOTE 7 – CAPITAL ASSETS

Following are the changes in capital assets for the years ended June 30, 2004 and 2003:

	Year Ended June 30, 2004				
	Balance July 1, 2003	Additions	Retirements	Transfers	Balance June 30, 2004
Capital assets not being depreciated:					
Land	\$ 4,276,003	\$ -	\$ (35,934)	\$ -	\$ 4,240,069
Museum and fine art	4,306,153	13,000	-	-	4,319,153
Library special collections	3,460,950	-	-	-	3,460,950
Livestock for educational purposes	2,751,710	6,000	-	-	2,757,710
Construction work-in-progress	5,885,805	4,948,339	(955,858)	(4,091,062)	5,787,224
Total capital assets not being depreciated	20,680,621	4,967,339	(991,792)	(4,091,062)	20,565,106
Other capital assets:					
Furniture and equipment	80,492,522	13,652,562	(7,690,741)	71,649	86,525,992
Library materials	52,821,531	3,470,280	(591,207)	-	55,700,604
Buildings	166,061,788	1,265,081	-	506,772	167,833,641
Building improvements	117,579,556	851,110	(32,374)	3,185,122	121,583,414
Land improvements	13,415,606	174,338	-	(460,628)	13,129,316
Infrastructure	31,336,047	3,883	-	788,147	32,128,077
Total other capital assets	461,707,050	19,417,254	(8,314,322)	4,091,062	476,901,044
Accumulated depreciation	(247,738,483)	(19,432,459)	7,615,854	-	(259,555,088)
Other capital assets, net	213,968,567	(15,205)	(698,468)	4,091,062	217,345,956
Intangible assets, net	2,119,264	(204,942)	(508,571)	-	1,405,751
Capital Assets, net	\$ 236,768,452	\$ 4,747,192	\$ (2,198,831)	\$ -	\$ 239,316,813
	Year Ended June 30, 2003				
	Balance July 1, 2002 (as restated)	Additions	Retirements	Transfers	Balance June 30, 2003
Capital assets not being depreciated:					
Land	\$ 4,212,403	\$ 63,600	\$ -	\$ -	\$ 4,276,003
Museum and fine art	4,306,153	-	-	-	4,306,153
Library special collections	3,460,950	-	-	-	3,460,950
Livestock for educational purposes	2,370,910	391,600	(10,800)	-	2,751,710
Construction work-in-progress	9,767,829	9,148,176	-	(13,030,200)	5,885,805
Total capital assets not being depreciated	24,118,245	9,603,376	(10,800)	(13,030,200)	20,680,621
Other capital assets:					
Furniture and equipment	74,991,262	8,713,667	(3,160,847)	(51,560)	80,492,522
Library materials	50,297,724	3,318,409	(794,602)	-	52,821,531
Buildings	165,794,851	254,400	(490,894)	503,431	166,061,788
Building improvements	103,604,687	2,823,148	-	11,151,721	117,579,556
Land improvements	11,834,000	840,205	-	741,401	13,415,606
Infrastructure	30,702,400	-	-	633,647	31,336,047
Total other capital assets	437,224,924	15,949,829	(4,446,343)	12,978,640	461,707,050
Accumulated depreciation	(233,365,958)	(18,244,283)	3,871,758	-	(247,738,483)
Other capital assets, net	203,858,966	(2,294,454)	(574,585)	12,978,640	213,968,567
Intangible assets, net	2,841,728	(774,024)	-	51,560	2,119,264
Capital Assets, net	\$ 230,818,939	\$ 6,534,898	\$ (585,385)	\$ -	\$ 236,768,452

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Historical records are not available for certain of the University's assets. As such, some values have been estimated based on insurance values, industry-accepted valuation techniques, or estimates made by University personnel knowledgeable as to the assets' values. Livestock held for educational purposes consist primarily of cattle herds. Breeding cattle are routinely replaced in the herds with their offspring; additions and deductions from the asset cost are not reported for reproducing cattle replaced in this manner.

NOTE 8 – DEFERRED REVENUES

Deferred revenues consisted of the following as of June 30:

	2004	2003
Grant and contract funds received in advance	\$ 4,694,327	\$ 5,686,122
Summer session payments received in advance	3,344,887	3,042,233
Other deferred revenues	321,099	242,748
Total	<u>\$ 8,360,313</u>	<u>\$ 8,971,103</u>

NOTE 9 – ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consisted of the following as of June 30:

	2004	2003
Compensation, benefits and related liabilities	\$ 15,811,290	\$ 15,559,375
Accrued interest expense	385,775	519,795
Accounts payable and other accrued liabilities	6,829,175	5,827,449
Total	<u>\$ 23,026,240</u>	<u>\$ 21,906,619</u>

NOTE 10 – NON-CURRENT LIABILITIES

Amounts not due within one year are reflected in the non-current liabilities section of the accompanying Statement of Net Assets, and as of June 30, 2004, include \$82,351,350 in bonds, notes and capital lease obligations, \$3,411,859 due to primary government and \$12,176,957 in compensated absence liabilities.

Following are the changes in non-current liabilities for the years ended June 30, 2004 and 2003:

	Year Ended June 30, 2004				
	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Amounts due within one year
Bonds and notes payable, and capital lease obligations					
Bonds payable, net of discount	\$ 89,158,295	\$ 18,533,399	\$ (22,075,000)	\$ 85,616,694	\$ 4,590,000
Notes and other debt	1,146,276	792,965	(300,735)	1,638,506	347,110
Capital lease obligations	151,312	10,796	(100,503)	61,605	28,345
Total bonds, notes and capital lease obligations	<u>\$ 90,455,883</u>	<u>\$ 19,337,160</u>	<u>\$ (22,476,238)</u>	<u>\$ 87,316,805</u>	<u>\$ 4,965,455</u>
Compensated absence liability	<u>\$ 22,896,157</u>	<u>\$ 11,214,154</u>	<u>\$ (10,851,509)</u>	<u>\$ 23,258,802</u>	<u>\$ 11,081,843</u>
Advances from primary government	<u>\$ 8,430,621</u>	<u>\$ 1,943,485</u>	<u>\$ (718,461)</u>	<u>\$ 9,655,645</u>	<u>\$ 869,649</u>
Due to Federal government	<u>\$ 20,254,326</u>	<u>\$ 524,409</u>	<u>\$ (7,044)</u>	<u>\$ 20,771,691</u>	<u>\$ -</u>

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Amounts not due within one year are reflected in the non-current liabilities section of the accompanying Statement of Net Assets, and as of June 30, 2003, include \$85,903,743 in bonds, notes and capital lease obligations, \$2,395,622 due to primary government, and \$12,254,032 in compensated absence liabilities.

	Year Ended June 30, 2003				
	Balance, July 1, 2002 (as restated)	Additions	Reductions	Balance June 30, 2003	Amounts due within one year
Bonds and notes payable, and capital lease obligations					
Bonds payable, net of discount	\$ 92,856,065	\$ 482,230	\$ (4,180,000)	\$ 89,158,295	\$ 4,235,000
Notes and other debt	854,944	680,169	(388,837)	1,146,276	220,866
Capital lease obligations	140,490	113,982	(103,160)	151,312	96,275
Total bonds, notes and capital lease obligations	\$ 93,851,499	\$ 1,276,381	\$ (4,671,997)	\$ 90,455,883	\$ 4,552,141
Compensated absence liability	\$ 21,673,555	\$ 11,304,457	\$ (10,081,855)	\$ 22,896,157	\$ 10,642,125
Advances from primary government	\$ 8,300,270	\$ 983,803	\$ (853,452)	\$ 8,430,621	\$ 660,862
Due to Federal government	\$ 19,812,258	\$ 462,702	\$ (20,634)	\$ 20,254,325	\$ -

Additional information regarding bonds, notes and capital leases is included in Notes 11 and 12.

NOTE 11 – BONDS, NOTES AND ADVANCES PAYABLE

Revenue bonds payable at June 30, 2004 were as follows:

Series 1993 A				
Payable during the year ending June 30,	Interest Rate	Principal	Interest	Total
2008	5.000%	\$ 1,208,611	\$ 1,206,389	\$ 2,415,000
2009	5.00 – 5.20 %	1,314,579	1,465,421	2,780,000
2010-2014	5.00 – 5.05 %	3,513,531	4,826,469	8,340,000
Total cash requirements		6,036,721	\$ 7,498,279	\$ 13,535,000
Bond discount amortized		4,280,165		
Balance, net of discount		\$ 10,316,886		

Series 1996 B				
Payable during the year ending June 30,	Interest Rate	Principal	Interest	Total
2005	5.750%	\$ 2,205,000	\$ 360,615	\$ 2,565,615
2006	5.750%	2,370,000	229,123	2,599,123
2007	5.750%	2,555,000	87,573	2,642,573
2008	5.750%	235,000	6,812	241,812
Total cash requirements		\$ 7,365,000	\$ 684,123	\$ 8,049,123

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Series 1996 D

Payable during the year ending June 30,	Interest Rate		Principal	Interest	Total
2005	4.750%	\$	640,000	\$ 2,139,405	\$ 2,779,405
2006	4.750%		670,000	2,108,297	2,778,297
2007	4.875%		705,000	2,075,204	2,780,204
2008	5.000%		740,000	2,039,524	2,779,524
2009	5.000%		650,000	2,004,751	2,654,751
2010-2014	5.125 - 5.25 %		3,800,000	9,469,157	13,269,157
2015-2019	5.375%		12,515,000	7,912,487	20,427,487
2020-2024	5.375%		18,515,000	2,385,106	20,900,106
2025-2029	5.375%		2,085,000	118,828	2,203,828
Total cash requirements		\$	40,320,000	\$30,252,759	\$ 70,572,759

Series 1998 E

Payable during the year ending June 30,	Interest Rate		Principal	Interest	Total
2005	4.200%	\$	265,000	\$ 343,763	\$ 608,763
2006	4.300%		280,000	343,763	623,763
2007	4.300%		290,000	343,763	633,763
2008	4.350%		305,000	343,763	648,763
2009	4.400%		315,000	343,763	658,763
2010-2014	4.50 - 4.85 %		1,820,000	343,763	2,163,763
2015-2019	5.000%		2,320,000	343,763	2,663,763
2020-2024	5.000%		1,700,000	343,763	2,043,763
Total cash requirements		\$	7,295,000	\$ 2,750,104	\$ 10,045,104

Series 1998 F

Payable during the year ending June 30,	Interest Rate		Principal	Interest	Total
2005	4.200%	\$	1,125,000	\$ 74,062	\$ 1,199,062
2006	4.300%		1,170,000	25,291	1,195,291
Total cash requirements		\$	2,295,000	\$ 99,353	\$ 2,394,353

Series 2003 G

Payable during the year ending June 30,	Interest Rate in effect 6/30/04 *		Principal	Interest	Total
2005	1.050%	\$	355,000	\$ 195,991	\$ 550,991
2006	1.050%		275,000	192,680	467,680
2007	1.050%		300,000	189,714	489,714
2008	1.050%		240,000	186,903	426,903
2009	1.050%		305,000	184,096	489,096
2010-2014	1.050%		7,360,000	812,474	8,172,474
2015-2019	1.050%		9,925,000	158,817	10,083,817
Total cash requirements		\$	18,760,000	\$ 1,920,675	\$ 20,680,675
Deferred Issuance costs			(735,192)		
Balance net of issuance costs		\$	18,024,808		

* Variable interest rate adjusted monthly

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Total, all series			
Payable during the year ending June 30,	Principal	Interest	Total
2005	\$ 4,590,000	\$ 3,113,836	\$ 7,703,836
2006	4,765,000	2,887,572	7,652,572
2007	3,850,000	2,672,419	6,522,419
2008	2,728,611	3,746,690	6,475,301
2009	2,584,579	3,947,770	6,532,349
2010-2014	16,493,531	16,338,708	32,832,239
2015-2019	24,760,000	8,798,030	33,558,030
2020-2024	20,215,000	2,515,705	22,730,705
2025-2029	2,085,000	118,828	2,203,828
Total cash requirements	82,071,721	\$44,139,558	\$126,211,279
Bond discount amortized	4,280,165		
Deferred issue costs	(735,192)		
Balance, net of discount	\$ 85,616,694		

Debt refunded, issued, and escrowed –

Issuance of Series A 1993 Bonds, November 9, 1993 Indenture – An original issue of \$24,911,720 dated November 9, 1993, consisting of \$3,055,000 of fully registered Current Interest Serial Bonds, plus \$6,036,720 of fully registered Capital Appreciation Bonds, and the remainder of fully registered Current Interest Term Bonds. A total of \$4.3 million was used to partially refund certain eligible portions of the Series B 1985 and Series A 1986 Indentures. The remainder of the proceeds was for the acquisition, construction, repair, remodeling, replacement, renovation, improvement, furnishing, and equipping of new and existing facilities at the University.

Issuance of the Series C 1994, June 16, 1994 Indenture – On June 16, 1994, the University issued Series C 1994 Revenue Bonds in the amount of \$12,250,000. Approximately \$10.5 million of the proceeds were deposited into an irrevocable trust with an escrow agent to debase eligible portions of the Auxiliary Facilities and Student Building Fees Revenue Bonds Series A 1987, the Facilities Refunding Revenue Bond Series A 1988, and the Facilities Improvement Refunding Revenue Bonds Series B 1985. The remainder was used to fund capital projects.

Issuance of the Series B 1996, October 1, 1996 Indenture – On October 1, 1996, the University issued Series B 1996 Facilities Refunding Revenue Bonds in the amount of \$18,995,000. Proceeds from the sale of the bonds were used to: 1) advance refund \$18,440,000 of outstanding Series A 1986 bonds; 2) pay the bond insurance premium; and 3) pay certain costs associated with the issuance of the bonds. This transaction culminated a forward purchase agreement entered into in August 1993 with certain institutional investors.

Issuance of Series D 1996, August 15, 1996 Indenture – On August 15, 1996, the University issued Series D 1996 Facilities Improvement and Refunding Revenue Bonds in the amount of \$44,530,000. Proceeds from the sale of the bonds were used to: 1) pay the costs of acquisition, construction, renovation, improvement, furnishing, and equipping certain facilities; 2) pay the bond insurance premium; and 3) pay certain costs associated with the issuance of the bonds. The bonds are fully insured by the Municipal Bond Insurance Association (MBIA).

The Series D 1996 bonds (and all subsequent bonds) are payable from and secured by a parity first lien on and pledge of certain gross and net revenues, which comprised: 1) all student building fees and certain student union use fees assessed against students attending the University; 2) net student

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housing system pledged revenues, after the payment of operation and maintenance expenses of such facilities; 3) certain rental and other income generated by the pledged facilities; 4) a HUD debt service grant; 5) lease rentals from the Museum of the Rockies; 6) all Land Grant income; 7) certain student athletic fees; 8) certain Health & Physical Education fees; 9) MSU- Bozeman Fieldhouse fees; and 10) capitalized interest and earnings on certain funds created under the Indenture.

Issuance of the Series E 1998, June 1, 1998 Indenture – On June 1, 1998, the University issued Series E 1998 Facilities Improvement Revenue Bonds in the amount of \$8,255,000. Proceeds from the sale of the bonds were used to: 1) finance the construction, improvement, repair, replacement, expansion, renovation, furnishing, and equipping of the Reno H. Sales Stadium at the Bozeman campus; 2) pay the premiums for the municipal bond insurance policy; and 3) pay certain costs associated with the issuance of the Series E 1998 bonds. Bonds maturing on or before November 15, 2008, are not subject to optional redemption prior to maturity. The MBIA unconditionally and irrevocably guarantees all bonds.

Issuance of the Series F 1998, June 1, 1998 Indenture – On June 1, 1998, the University issued Series F 1998 Facilities Improvement Revenue Bonds (Information Technology Project), in the amount of \$8,175,000. Proceeds were used for the purchase, installation and implementation of the Banner2000 software and required equipment, training and support. The bonds are unconditionally and irrevocably guaranteed by the MBIA, and are not subject to optional redemption prior to maturity.

Issuance of the Series G 2003, October 15, 2003 Indenture - On October 15, 2003, the University issued \$18,760,000 in Municipal Auction Rate Securities as Series 2003 G Revenue Bonds. Of this total, \$16,745,000 was used for a current refunding of the Series 1993-A bonds and \$2,015,000 was used for an advance refunding of the Series 1994 C bonds. The new bonds are ten year variable rate bonds, priced on a 35-day rate period. They are unconditionally and irrevocably guaranteed by XL Capital Assurance. The bonds were issued in denominations of \$25,000, with principal repayments scheduled each May 15 and November 15 through November, 2016. Bond proceeds, along with monies from the University, were sufficient to legally defease that portion of the Series 1993 A bonds that were called, and the Series 1994 C bonds that will be called on November 15, 2004. The refunding resulted in an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$1,451,453. The refunded debt is considered defeased and is not reported in the University's financial statements.

Defeased bonds – In prior years, the University defeased certain bond issues by placing proceeds of new bonds in an irrevocable trust. The proceeds, together with interest earned thereon, will be sufficient for future debt service payments on the refunded issues. Accordingly, neither the trust account assets nor the liability for the defeased bonds are included in the University's financial statements. Certain of the transactions met the qualifications for legal defeasance, while others are considered to be defeased in substance. At June 30, 2004 and 2003, \$4,965,000 and \$5,640,000 of bond principal outstanding was considered to be defeased in substance.

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Notes payable – consisted of the following as of June 30:

Description	Interest Rate	Maturity Date	2004	2003
<i>GE Capital:</i>				
				\$
Library Computing Equipment	5.78%	01/01/04	\$ -	7,269
Architecture	5.50%	03/01/04	-	1,599
Great Falls Library 1	5.90%	04/01/04	-	2,778
Great Falls Library 2	4.99%	09/01/04	493	2,405
Bozeman Library	4.99%	09/01/04	3244	15,828
ITC Wiring Project	4.18%	09/01/07	569,924	-
<i>Subtotal, GE Capital Loan Principal</i>			<u>573,661</u>	<u>29,879</u>
<i>Key Municipal Finance-</i>				
Renne Library	4.10%	02/01/05	89,813	176,057
<i>Accutitle Incorporated-</i>				
3009 Yucca Escrow Agreement	7.75%	10/27/04	6,692	28,701
<i>Independence Bank</i>				
Admissions Auto Loan	0%	09/01/07	18,288	-
<i>Cisco:</i>				
Information Technology Services Equipment	5.75%	12/20/05	40,641	72,493
Information Technology Services Cable	5.75%	06/20/06	91,763	137,128
<i>Subtotal, Cisco Loan Principal</i>			<u>132,404</u>	<u>209,621</u>
<i>MSU-Northern Foundation:</i>				
Athletics Wrestling Van	6.50%	10/01/04	2,343	4,543
MacKenzie Hall Wiring	5.00%	10/01/11	124,263	124,263
Campus Backbone Wiring	5.00%	10/01/11	225,243	201,624
Digital Phone System	5.00%	10/01/11	133,901	133,901
Brockman Wiring	5.00%	10/01/11	46,062	46,062
ITS Electronics	5.00%	10/01/11	275,700	174,319
Student Services Office Equipment and Carpeting	6.50%	10/01/04	5,290	10,258
Athletics Volleyball Van	6.50%	10/01/05	4,846	7,048
<i>Subtotal, MSU-Northern Foundation Loan Principal</i>			<u>817,648</u>	<u>702,018</u>
Total note principal outstanding			<u>\$ 1,638,506</u>	<u>\$ 1,146,275</u>

Scheduled note maturities are as follows:

Payable during the year ending June 30,	Principal	Interest	Total
2005	\$ 347,109	\$ 43,847	\$ 390,956
2006	222,696	40,536	263,232
2007	172,404	40,258	212,662
2008	214,002	40,539	254,542
2009	151,921	34,115	186,036
2010-2014	530,373	56,605	586,978
Total	<u>\$ 1,638,506</u>	<u>\$ 255,900</u>	<u>\$ 1,894,406</u>

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Advances payable to primary government – The University participates in the State's InterCap loan program. InterCap loans contain a variable interest rate, which is based on the underlying bond rate of the Montana Board of Investments InterCap bonds, and is adjusted annually. The rate as of June 30, 2004, was 2.70%.

Other advances were made during the mid- 1990s by the Montana Science and Technology Alliance (MSTA) to stimulate research and creative activities in Montana. Such loans were subsequently assumed by the State of Montana Board of Investments. Amounts are expected to be repaid as follows; however, actual payments are allocated between three of the state institutions of higher education based on relative proportions of annual Research and Creative Activities expenditures, and actual repayments and the timing thereof may vary.

Payable during the year ending June 30,	InterCap Loans			MSTA Advances		
	Principal	Interest	Total	Principal	Interest	Total
2005	\$ 824,978	\$ 102,563	\$ 927,541	\$ 44,671	\$ 135,329	\$ 180,000
2006	912,392	79,610	992,002	45,786	134,214	180,000
2007	813,034	64,562	877,596	46,930	133,070	180,000
2008	705,049	42,188	747,237	48,102	131,898	180,000
2009	484,716	23,067	507,783	49,303	130,697	180,000
2010-2014	492,244	20,210	512,454	265,611	634,389	900,000
2015-2019	4,424	-	4,424	300,477	599,523	900,000
2020-2024	-	-	-	339,919	560,081	900,000
2025-2029	-	-	-	384,538	515,462	900,000
2030-2034	-	-	-	435,015	464,985	900,000
2035-2039	-	-	-	492,117	407,883	900,000
2040-2044	-	-	-	556,714	343,286	900,000
2045-2049	-	-	-	629,791	270,209	900,000
2050-2054	-	-	-	712,461	187,539	900,000
2055-2059	-	-	-	805,981	94,019	900,000
2060-2061	-	-	-	261,392	8,608	270,000
Total	\$ 4,236,837	\$ 332,200	\$ 4,569,037	\$ 5,418,808	\$ 4,751,192	\$ 10,170,000

NOTE 12 - CAPITAL LEASE OBLIGATIONS

Capital Leases: The University has future minimum lease commitments for capital lease obligations consisting of the following at June 30, 2004:

Payable during the year ending June 30,	Principal and Interest
2005	\$ 33,249
2006	25,316
2007	10,640
Total payments	69,205
Less amount representing interest	(7,600)
Principal balance outstanding	\$ 61,605

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NOTE 13 – UNRESTRICTED NET ASSETS

As of June 30, the University's unrestricted net assets consisted of the following:

	2004	2003
General operating funds	\$ (12,934,811)	\$ (14,460,012)
Facility renewal and replacement funds	13,340,446	15,821,325
Student services and auxiliary department reserves, including inventories	12,446,348	10,672,366
Instruction, academic support and public service department funds	7,946,789	7,315,006
Indirect cost recoveries and research-related funds	7,138,459	6,053,954
Unexpended plant funds	3,677,161	3,459,516
Retirement of indebtedness funds	3,366,200	3,050,449
Facilities services balances, including inventories	2,407,092	2,267,021
Employer-provided benefits reserves	1,186,599	1,181,719
Agricultural Experiment Station and Extension Services funds	2,056,702	1,521,055
Administration and finance department funds	2,722,041	2,348,894
Student organization funds	764,305	930,945
Livestock inventories	519,225	672,610
President's office funds	739,817	660,545
Other funds	-	88,318
Total unrestricted net assets	<u>\$ 45,376,373</u>	<u>\$ 41,583,711</u>

The University has not funded the compensated absences balance related to employees paid using unrestricted funds, creating negative net asset balances of \$12.9 million and \$14.5 million as of June 30, 2004 and 2003, respectively. Other funds have largely been earmarked for minor and major equipment replacement, facility renovation, operating contingencies, and maintenance and renovation projects in progress as of June 30.

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NOTE 14 – MATRIX OF NATURAL AND FUNCTIONAL OPERATING EXPENSES

The University's operating expenses consisted of the following during the year ended June 30, 2004:

Type and classification of operating expense:	Instruction	Organized Research	Public Service	Academic Support	Student Services	Institutional Support	Plant-related Expenses	Auxiliary Enterprises	Other Classifications	Total
Compensation	\$ 57,932,179	\$ 41,086,258	\$ 12,486,942	\$ 11,306,799	\$ 11,139,849	\$ 9,269,892	\$ 4,779,404	\$ 12,353,939	\$ -	\$ 160,355,262
Benefits	15,422,926	9,798,883	3,514,690	3,006,254	2,922,570	2,909,473	2,089,765	3,307,481	-	42,972,042
Contracted Services	2,797,726	14,051,285	4,380,449	1,080,532	2,315,422	1,932,601	2,781,905	2,933,254	-	32,273,174
Supplies	2,712,067	7,931,072	1,216,496	1,240,505	1,600,527	365,240	3,348,261	4,275,605	-	22,689,773
Communications	1,120,837	640,142	640,479	298,749	1,159,330	196,817	165,259	548,328	-	4,769,941
Travel	1,420,717	3,680,962	1,032,450	684,286	2,004,172	295,683	24,573	126,269	-	9,269,113
Utilities	6,405	345,775	24,544	32,637	71,533	-	5,187,126	2,188,487	-	7,856,507
Cost of Sales	47,421	20	155,057	973,619	81,453	164,629	13,100	4,129,683	-	5,564,981
Maintenance	342,931	821,430	114,701	206,449	229,220	28,648	6,057,130	2,194,003	-	9,994,512
Other Expenses	831,798	979,523	2,037,266	303,031	1,025,088	2,035,261		507,987	-	7,719,954
Rent	122,867	901,180	212,122	88,101	228,964	151,512	750,030	343,812	-	2,798,588
Scholarships and Fellowships	-	-	-	-	-	-	-	-	15,312,605	15,312,605
Depreciation and Amortization	-	-	-	-	-	-	-	-	20,803,902	20,803,902
Total	\$ 82,757,874	\$ 80,236,529	\$ 25,815,196	\$ 19,220,962	\$ 22,778,128	\$ 17,349,756	\$ 25,196,553	\$ 32,908,849	\$ 36,116,507	\$ 342,380,354

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The University's operating expenses consisted of the following during the year ended June 30, 2003:

Type and classification of operating expense:	Instruction	Organized Research	Public Service	Academic Support	Student Services	Institutional Support	Plant-related Expenses	Auxiliary Enterprises	Other Classifications	Total
Compensation	\$ 56,021,935	\$ 38,768,728	\$13,812,963	\$ 10,692,509	\$ 10,608,285	\$ 9,107,202	\$ 4,875,721	\$ 11,553,462		\$ 155,440,805
Benefits	14,312,848	8,754,481	3,695,743	2,608,879	2,579,955	2,622,645	2,324,922	2,884,848		39,784,321
Contracted services	2,953,535	13,381,156	3,981,305	1,006,014	2,075,101	2,119,159	2,310,646	1,432,907		29,259,823
Supplies	2,703,847	7,548,543	1,228,430	1,102,873	1,493,963	327,083	2,054,264	3,973,988		20,432,991
Communications	1,175,948	607,779	534,805	285,260	1,013,674	271,897	136,874	546,765		4,573,002
Travel	1,222,374	3,220,829	1,195,769	721,200	1,662,409	258,549	9,039	130,811		8,420,980
Utilities	12,752	272,590	16,744	28,376	59,048	390	4,182,225	2,040,722		6,612,847
Cost of sales	47,704	138,966	28,761	657,555	17,124	15,544	47,029	4,491,937		5,444,620
Maintenance	289,364	879,353	124,091	280,502	152,567	148,623	3,502,488	2,007,981		7,384,969
Other expenses	121,837	389,807	336,809	67,842	156,854	169,796	721,218	317,449		2,281,612
Rent	930,899	1,126,236	2,437,230	825,840	1,024,310	1,943,399	68,275	610,305		8,966,494
Scholarships and Fellowships				-	-	-		-	15,501,298	15,501,298
Depreciation and Amortization			-				-		19,627,347	19,627,347
Total	\$ 79,793,043	\$ 75,088,468	\$ 27,392,650	\$ 18,276,850	\$ 20,843,290	\$ 16,984,287	\$ 20,232,701	\$ 29,991,175	\$35,128,645	\$ 323,731,109

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NOTE 15 – RETIREMENT PLANS

University employees eligible to participate in retirement programs are members of either the Public Employees' Retirement System (PERS), the Game Wardens and Peace Officers Retirement System (GWPORS), Teacher's Retirement System (TRS) the Optional Retirement Program (ORP), Federal Employees' Retirement System (FERS) or the U.S. Civil Service Retirement System (CSRS). ORP commenced in January 1988, and is underwritten by the Teachers' Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF). Effective July 1, 1993, ORP was made the mandatory retirement plan for new faculty and administrative staff. The Pension Benefit Obligation is not available on an individual agency basis, but is available on a statewide basis from the Montana Retirement systems or TIAA-CREF.

ORP - The ORP is a defined contribution plan, established under authority of Title 19, Chapter 21, MCA. Benefits at retirement depend upon the amount of investment gains and losses and the employee's life expectancy at retirement. Under the ORP, each employee enters into an individual contract with TIAA-CREF. The University records employee/employer contributions, and remits monies to TIAA-CREF. Individuals are immediately vested with contributions. Annual reports that include financial statements and required supplemental information on the plan are available from TIAA-CREF, 730 Third Avenue, New York, New York 10017-3206, Phone 1-800-842-2733.

TRS - This system was established in 1937 and is governed by Title 19, Chapter 4, MCA, as a cost-sharing multi-employer defined benefit pension plan providing retirement services to all persons employed as teachers or professional staff of any public elementary or secondary school, vocational-technical center or unit of the University System. Eligibility is met with a minimum of 25 years of service or age 60 with 5 years of creditable service. The formula for benefits is 1/60 times creditable service years times average final compensation. Rights are vested after 5 years of creditable service, and vested employees may retire at or after age 50 and receive reduced retirement benefits. Additional information or a separate financial statement can be obtained from the State of Montana, Department of Administration, Teachers' Retirement Division, P.O. Box 200139, Helena, MT 59620-0139.

PERS - This system was established in 1945 and is governed by Title 19, Chapter 3, MCA, as a cost-sharing multi-employer defined benefit pension plan providing retirement services to substantially all public employees. Effective July 1, 2002, eligible new employees of the University are defaulted into the PERS defined benefit plan and have one year from their date of hire to elect whether to stay in the PERS defined benefit plan, enroll in the ORP plan, or enroll in the PERS Defined Contribution Plan. Benefit eligibility is age 60 with at least 5 years of service, age 65 regardless of service, or 30 years of service regardless of age. Actuarially reduced benefits may be taken with 25 years of service or at age 50 with at least 5 years of service. Monthly retirement benefits are determined by multiplying 1/56 by the number of years of service by the final average salary, unless the employee has 25 years of service in which case the multiplier is 1/50. Members' rights become vested after 5 years of service. Additional information or a separate financial statement can be obtained from the State of Montana, Department of Administration, Public Employees' Retirement Administration, P.O. Box 200131, Helena, MT 59620-0131.

GWPORS – This retirement system was established in 1963 and is governed by Title 19, Chapter 8, MCA, to provide retirement services for all persons employed as game wardens and peace officers. Effective July 1, 1997, this system became the mandatory system for campus security officers employed by the Montana University System, unless they already held membership in another State retirement system. Participants are eligible to retire after completing 20 years of service and reaching age 50. Early retirement with a reduced benefit may be taken after completing 5 years of service and reaching 55 years of age. The retirement formula is 2% of the final average salary per year of service. Members' rights become vested after 5 years of service. Additional information or a separate financial statement can be

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obtained from the State of Montana, Department of Administration, Public Employees' Retirement Administration, P.O. Box 200131, Helena, MT 59620-0131.

FERS - This plan commenced in 1986 and is available to Federal employees joining the Extension Service staff without a break in service. This retirement plan contains defined benefit plan components, a Basic Benefit Plan and Social Security, and a defined contribution component, the Thrift Savings Plan (TSP). Basic benefits can be received at age 55 with as little as 10 years of service, and minimum retirement benefits at age 62 with 5 years of service. The formula for basic benefits is 1% of the highest consecutive three-year-average salary multiplied by the number of years of service. At age 62, retirees are eligible for cost of living adjustments on retirement benefits. The TSP benefits at retirement depend upon the amount of employer contributions, employee voluntary contributions and investment gains and losses.

CSRS - This retirement plan is authorized under the Smith-Lever Act of 1914 as amended and is available to Federal employees joining the Extension Service staff without a break in service. CSRS is a defined benefit plan. The retirement benefits are based upon the highest consecutive three-year-average salary. Retirees are eligible for cost of living adjustments the year after retirement. Benefits can be received at age 55 with 30 years of service, age 60 with 20 years of service, or age 62 with five years of service.

Pension data for the year ended June 30, 2004:

	PERS	TRS	ORP	CSRS	FERS	GWPORS
Covered payroll	\$ 38,746,770	\$ 18,836,968	\$ 78,448,435	\$ 2,697,199	\$ 763,308	\$ 357,044
Total Payroll	\$166,370,885	\$166,370,885	\$166,370,885	\$166,370,885	\$166,370,885	\$166,370,885
Employer contributions	\$ 2,673,527	\$ 1,908,144	\$ 3,858,736	\$ 102,938	\$ 83,681	\$ 32,134
% of covered payroll	6.900%	7.47%	4.49 - 4.96%	3.82 - 7.54%	1.00-10.00%	9.00%
Employee contributions	\$ 2,673,527	\$ 1,346,843	\$ 5,516,895	\$ 135,529	\$ 70,951	\$ 37,704
% of covered payroll	6.900%	7.15%	7.032%	0.107 - 5.25%	0.01 - 8.50%	10.560%
ORP contribution to other plans	\$ 150,832	\$ 2,909,052				
% of ORP contribution	2.41%	4.04%				

Covered payroll excludes students employed under the College Work Study programs and part-time student employees.

Amounts contributed to retirement plans during the past three years were equal to the required contribution each year. The amounts contributed by the University and its employees were:

Year ended June 30,	PERS	TRS	ORP	CSRS	FERS	GWPORS
2002	\$ 5,526,092	\$ 6,528,302	\$ 7,097,452	\$ 299,771	\$ 86,104	\$ 44,700
2003	\$ 5,709,572	\$ 7,111,003	\$ 8,298,780	\$ 377,067	\$ 147,761	\$ 59,010
2004	\$ 5,497,886	\$ 6,164,039	\$ 9,375,631	\$ 238,517	\$ 154,632	\$ 69,838

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Pension data for the year ended June 30, 2003:

	PERS	TRS	ORP	CSRS	FERS	GWPORS
Covered payroll	\$ 41,029,441	\$ 25,427,911	\$ 69,256,713	\$ 2,175,692	\$ 729,009	\$ 301,688
Total Payroll	\$158,541,604	\$158,541,604	\$ 158,541,604	\$ 158,541,604	\$158,541,604	\$ 158,541,604
Employer contributions	\$ 2,831,032	\$ 2,573,985	\$ 3,423,176	\$ 169,273	\$ 82,802	\$ 27,152
% of covered payroll	6.900%	7.470%	4.490-4.956%	7.77-7.94%	11.360%	9.000%
Employee contributions	\$ 2,831,032	\$ 1,818,093	\$ 4,875,604	\$ 207,794	\$ 64,959	\$ 31,858
% of covered payroll	6.900%	7.150%	6.9 - 7.044%	0.8 - 6.93%	0.800%	10.560%
ORP contribution to TRS	\$ 47,508	\$ 2,718,925	-	-	-	-
% of ORP contribution to TRS	2.41%	4.04%	-	-	-	-

NOTE 16 – RISK MANAGEMENT

Due to the diverse risk exposure of the University and its constituent agencies, the insurance portfolio contains a comprehensive variety of coverage. Montana statutes, Sections 2-9-101 through 305, MCA, and ARM Section 2-2-298, require participation of all state agencies in the self- insurance plan established by the Montana Department of Administration, Risk Management and Tort Defense Division (RMTDD). The self- insurance program includes coverage for commercial general liability, auto liability, professional liability, and errors and omissions exposures. The RMTDD provides coverage, above self- insured retentions, by purchasing other commercial coverage through the State's broker, Willis of Seattle, for excess property, crime, fidelity, boiler and machinery, and fine arts coverage. Coverage for aircraft and hull liability is held through Mountain Air. The RMTDD also supplies other commercial insurance coverage for specific risk exposures on an as needed basis such as the Volunteer Accident and Health, Dismemberment and Accidental Death coverage obtained for all units of the Montana University System. In addition to these basic policies, the University's Department of Safety and Risk Management ("SRM") establishes guidelines and provides consultation in risk assessment, risk avoidance, risk acceptance and risk transfer.

The Tort Claims Act of the State of Montana, Section 2-9-102, MCA, "provides that Governmental entities are liable for its torts and of those of its employees acting within the course and scope of their employment or duties whether arising out of a governmental or proprietary function, except as specifically provided by the Legislature." Accordingly, Section 2-9-305, MCA, requires that the State "provide for the immunization, defense and indemnification of its public officers and employees civilly sued for their actions taken within the course and scope of their employment." Safety and Risk Management also provides commercial coverage for other risk exposures that are not covered by the State's self- insurance program.

Buildings and contents – are insured for replacement value. For each loss covered by the State's self- insurance program and commercial coverage, MSU has a \$1,000 per occurrence retention.

General liability and tort claim coverage – include comprehensive general liability, auto liability, personal injury liability, officer's and director's liability, professional liability, aircraft liability, watercraft liability, leased vehicles and equipment liability, and are provided for by the University's participation in the State's self- insurance program.

Self-Funded Programs – The University's health care program is self-funded, and is provided through participation in the Montana University System (MUS) Inter-unit Benefits Program. The MUS program is funded on an actuarial basis and the University believes that sufficient reserves exist to pay run-off claims.

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related to prior years, and that premiums and University contributions are sufficient to pay current and future claims.

Effective July 1, 2003, the University adopted a self-funded workers' compensation insurance program, provided through membership in the MUS Self Insured Worker's Compensation Program. The MUS program is funded on an actuarial basis and is administered by a third party, Missoula County. Benefits provided are prescribed by state law and include biweekly payments for temporary loss of wages as well as qualifying permanent partial and permanent total disability. Medical and indemnity benefits are statutorily prescribed for qualifying job-related injuries or illnesses.

The MUS program incorporates a self- insured retention of \$500,000 per claim and excess commercial coverage to statutory limits. Employer's liability is provided, with a \$500,000 retention and an excess insurance limit of \$1,000,000. The University provides periodic disbursements to the administrator for claims paid and administrative expenses.

NOTE 17 – COMMITMENTS AND CONTINGENT LIABILITIES

Operating leases – The University is committed under non-cancelable operating leases as follows:

Minimum rental payments for operating leases are due in the years ending June 30,	Amount
2005	\$1,453,136
2006	1,100,432
2007	890,577
2008	833,368
2009	714,055
2010 - 2014	3,355,051
2015 - 2019	2,678,904
Total	<u>\$ 11,025,523</u>

Payments made under non-cancelable operating leases during the years ended June 2004 and 2003 totaled \$1,250,187 and \$467,191, respectively.

Legal actions – The University is a defendant in legal actions arising in the normal course of business. While the outcome cannot be determined at this time, management is of the opinion that the liability, if any, from these actions will not have a material effect on the University's financial position, results of operations or cash flows.

Refundable grants – The University receives grants and other forms of reimbursement from various Federal and State agencies. These funds are subject to review and audit by cognizant agencies. The University does not expect any material adjustments or repayments to result from such audits.

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As of June 30, 2004, the University had initiated construction or was authorized to do so on the following major capital and maintenance projects:

Description	Amount Expended through June 2004	Remaining Amount Authorized	Total Expected Project Cost
Chemistry/Biochemistry Facility	\$ -	\$ 24,500,000	\$ 24,500,000
Student Facilities Enhancement Project	-	28,000,000	28,000,000
Animal Bioscience Facility	12,081	4,818,050	4,830,131
SARC Renovation	45,692	553,928	599,620
EARC Renovation	1,050	197,801	198,850
NARC Renovation	-	200,000	200,000
NWARC Renovation	-	160,000	160,000
Herrick Comprehensive Study	6,711	4,555	11,266
MSU- Bozeman Skybox II	168,159	6,841	175,000
Fieldhouse Roof Replacement	1,235,878	1,114,122	2,350,000
Cooley B-1,2,3	40,358	99,642	140,000
Cobleigh Hall Re-roof	15,693	255,414	271,107
Roskie Hall Renovation	23,366	412,634	436,000
Grant Chamberlain Parking Lot Replacement	26,565	198,435	225,000
Faculty Court Lab Renovations	28,291	15,709	44,000
Montana Hall Air Conditioning	16,210	97,580	113,790
Cobleigh Clean Room and Lab Renovation	60,879	69,121	130,000
Museum of the Rockies Renovation	142,271	207,729	350,000
EPS Building Clean Room	24,843	1,955,157	1,980,000
EHHD Air Conditioning	29,630	330,370	360,000
A.S. & Science Building Roofs	144,822	89,578	234,400
Energy Monitoring System	-	72,000	72,000
Residence Halls Fire Suppression	204,668	145,332	350,000
PE Building Showers	3,051	244,449	247,500
Athletic Training Room	18,394	7,606	26,000
COT Parking Lot	-	150,000	150,000
Hart Albin Building 1st Floor	205,493	40,007	245,500
Applied Technology Center Construction	519,098	3,565,852	4,084,950
Cowan Hall Heating and Air Conditioning	2,298,755	61,945	2,360,700
Morgan/Brockman Roofs	117,410	140,884	258,295
Patch/Coat/Seal Roofs	103,198	232,232	335,430
Shingle/Roof Repairs	349	562,545	562,894
Hail/Damage Repair	60,267	30,311	90,578
L Johnson Hall Re-roof	87,452	147,632	235,084
MSU ADA Compliance Study	29,162	18,487	47,649
Traphagen Eaves Repair	40,885	6,106	46,991
Lewis Eaves Repair	136,701	9,299	146,000
Cobleigh Masonry Stabilization	24,500	500	25,000
Totals	\$ 5,871,882	\$ 68,721,853	\$ 74,593,735

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NOTE 18 – RELATED PARTIES

Private nonprofit organizations with relations to the University include MSU-Bozeman Foundation, MSU-Billings Foundation (including the Sting Athletic Association and the Alumni Association), MSU-Northern Foundation, MSU-Bozeman Alumni Association, MSU-Bozeman Athletic Scholarship Association, MSU-Bozeman Bookstore, MSU-Bozeman Friends of KUSM, MSU-Billings Friends of KEMC and the Museum of the Rockies, Inc. As discussed in note 20, certain of the parties are considered Component Units of the University. Detailed information regarding the transactions occurring between the University and its component units is presented in note 20.

During the years ended June 30, 2004 and 2003, respectively, the Foundations provided to the University \$5,548,157 and \$6,552,129 in scholarship and other gift support. In addition, during 2004, the University recorded restricted gift revenue of approximately \$2.8 million related to an amount receivable from the MSU-Bozeman foundation. The University provided to its Foundations \$1,520,600 and \$1,311,366, during the years ended 2004 and 2003, respectively, which included payments for contracted services, capital campaign support, and operating leases. In addition, renovations of leased space valued at \$66,866 were completed during 2003.

Friends of Montana Public Television provided \$414,072 during 2004 and \$415,333 during 2003, and Friends of KEMC Public Radio provided \$425,000 during 2004 and \$310,000 during 2003 in support of the University's television and radio stations.

The Museum of the Rockies, Inc. paid \$300,000 per year to the University for facility rental, and provided \$1,571,784 and \$1,186,305 during the fiscal years ended June 2004 and 2003, respectively, in support of the University, primarily as reimbursement for Museum staff salaries and benefits.

The MSU-Bozeman Athletic Scholarship Association provided \$489,157 and \$439,980 in support of athletic programs during the years ended June 30, 2004 and 2003.

NOTE 19 – SUBSEQUENT EVENTS

At its April, 2004, meeting, the Board of Regents authorized the construction of a new Chemistry/Biochemistry Research Laboratory Facility on the campus of Montana State University-Bozeman. In November 2004, the University issued \$23.7 million in Series H 2004 Facilities Improvement Revenue Bonds to fund the project. The traditional fixed rate issue carries an effective interest rate of 4.61%.

In November, 2004, the Board of Regents authorized the issuance of Series I 2004 Facilities Revenue Refunding Bonds to refund a significant portion of the Series D 1996 bonds currently outstanding. The bonds, maturing in November 2025, are expected to be issued at a face value of \$31.48 million and result in a calculated savings of approximately \$1.8 million over the repayment period.

The University anticipates issuing bonds to fund the majority of a student facilities enhancement project on the Bozeman campus. The design and construction of the facilities have been approved by the Board of Regents; however, construction will not proceed until satisfactory funding is arranged. The University plans to seek Regental approval for the issuance of approximately \$25 million in indebtedness, to be repaid with a combination of student fees and auxiliary operations revenues.

Montana State University
(a component unit of the State of Montana)
Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2004
(continued)

NOTE 20 – COMPONENT UNITS

The entities included as component units in the financial statements are nonprofit, tax exempt organizations operating exclusively for the purposes of encouraging, promoting and supporting educational programs, research, scholarly pursuits and athletics at, or in connection with the University. Although the University may not control the timing or amount of receipts from these entities, the majority of the revenues or incomes thereon that the entities hold and invest are restricted by donors to the activities of the University. The entities included as component units in the financial statements are the MSU Foundation (406-994-2053), the MSU-Billings Foundation (406-657-2244), the MSU-Northern Foundation (406-265-3711), the MSU- ASA (Athletic Scholarship Association)(406-994-3741), and the Museum of the Rockies, Inc.(406-994-3466).

Condensed financial information for each of the University's component units is presented below.

Condensed Combining Schedule of Component Unit Statements of Financial Position
As of June 30, 2004*

	Montana State University Foundation	Montana State University- Billings Foundation	Montana State University- Northern Foundation	Museum of the Rockies, Inc.	MSU-ASA	Combined
Assets:						
Cash and investments	\$ 88,705,758	\$12,592,601	\$ 3,997,887	\$ 6,860,544	\$ 2,241,915	\$ 114,398,705
Amounts due from MSU	-	-	817,648	-	-	817,648
Other receivables, net	3,623,161	2,185,426	940,937	98,109	33,330	6,880,963
Capital assets, net	3,308,177	1,458,058	12,378	1,243,187	11,989	6,033,789
Other assets	1,306,150	142,648	61,230	1,567,329	4,782	3,082,139
Total assets	\$ 96,943,246	\$16,378,733	\$ 5,830,080	\$ 9,769,169	\$ 2,292,016	\$ 131,213,244
Liabilities:						
Accounts payable and other liabilities	803,736	551,214	50	139,235	539,808	2,034,043
Amounts due to MSU	2,775,858	-	-	380,576	347,950	3,504,384
Notes, bonds and debt obligations	2,581,957	122,675	-	30,099	-	2,734,731
Liabilities to external parties	1,010,479	226,172	1,910,413	-	-	3,147,064
Custodial funds	7,551,420	1,227,375	-	-	-	8,778,795
Total liabilities	14,723,450	2,127,436	1,910,463	549,910	887,758	20,199,017
Net assets:						
Unrestricted	2,468,453	3,998,561	329,406	5,550,669	137,161	12,484,250
Temporarily restricted	24,440,750	2,735,630	992,144	2,851,591	-	31,020,115
Permanently restricted	55,310,593	7,517,106	2,598,067	816,999	1,267,097	67,509,862
Total net assets	82,219,796	14,251,297	3,919,617	9,219,259	1,404,258	111,014,227
Total liabilities and net assets	\$ 96,943,246	\$16,378,733	\$ 5,830,080	\$ 9,769,169	\$ 2,292,016	\$ 131,213,244

* The Museum of the Rockies, Inc. and the MSU- ASA maintain a December 31 year-end. All other component units' year-ends coincide with the University's June 30 fiscal year.

Montana State University
(a component unit of the State of Montana)
Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2004
(continued)

Condensed Combining Schedule of Component Unit Statements of Activities
For the Year ended June 30, 2004*

	Montana State University Foundation	Montana State University- Billings Foundation	Montana State University- Northern Foundation	Museum of the Rockies, Inc.	MSU- ASA	Combined
Revenues:						
Contributions	\$ 9,472,259	\$ 984,585	\$ 877,823	\$ 481,629	\$ 542,265	\$ 13,632,902
Investment income and unrealized gain on investments	6,982,003	1,107,186	652,848	509,374	4,206	9,255,617
Support from University	179,135	1,209,265	132,200	-	-	1,520,600
Other income (expense)	2,168,201	(15,000)	11,724	1,996,583	622,245	4,783,753
Total revenues	18,801,598	4,560,377	1,674,595	2,987,586	1,168,716	29,192,872
Expenses:						
University support	3,617,425	1,238,048	692,684	917,430	531,219	6,996,806
Other program services	1,106,075	749,776	328,768	1,154,462	-	3,339,081
Supporting services	2,571,895	537,287	192,846	673,916	637,497	4,613,441
Total expenses	7,295,395	2,525,111	1,214,298	2,745,808	1,168,716	14,949,328
Change in net assets before nonoperating items	11,506,203	2,035,266	460,297	241,778	-	14,243,544
Non-operating expenses	(27,506)	(80,000)	-	-	-	(107,506)
Change in net assets	11,478,697	1,955,266	460,297	241,778	-	14,136,038
Net assets, beginning of year	70,741,099	12,296,031	3,459,320	8,977,481	1,404,258	96,878,189
Net assets, end of year	\$ 82,219,796	\$ 14,251,297	\$ 3,919,617	\$ 9,219,259	\$ 1,404,258	\$ 111,014,227

* The Museum of the Rockies, Inc. and the MSU- ASA maintain a December 31 year-end. All other component units' year-ends coincide with the University's June 30 fiscal year.

Component Unit Investment Composition as of June 30, 2004*:

Pooled investments:	
Equity securities	\$ 48,668,136
Debt securities	26,893,214
Alternative investments	13,190,321
Cash equivalents	735,853
US Treasuries	622,788
Other real estate	998,338
Other investments	11,185,755
Interest in Private Foundation	3,846,000
Investments held in trust	1,761,050
Total	\$ 107,901,455



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December 3, 2004

Mr. Scott A. Seacat
Legislative Auditor
Legislative Audit Division
State Capitol, Room 135
P O Box 201705
Helena MT 59620-1705

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LEGISLATIVE AUDIT DIV.

Dear Mr. Seacat:

Montana State University would like to thank the Legislative Audit Division for their time in auditing the financial statements for the fiscal year ended June 30, 2004. We feel this audit was productive and instrumental in continually improving the financial reporting of all Montana State University campuses. We look forward to working with you again next year.

Sincerely,

A handwritten signature in cursive script, appearing to read "Gamble".

Geoffrey Gamble
President

Enc.